REPORT OF THE INTERDEPARTMENTAL TASK FORCE ON FOREIGN INVESTMENT

DEPARTMENTS OF

TREASURY AND ECONOMICS
TRADE AND DEVELOPMENT
FINANCIAL AND COMMERCIAL AFFAIRS

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REPORT OF THE INTERDEPARTMENTAL TASK FORCE

ON FOREIGN INVESTMENT

Ontario
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Department of Financial and Commercial Affairs

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PREFACE

In late 1970, the Ontario Department of Treasury and Economics initiated the formation of a small Interdepartmental Task Force to study the national, as well as provincial, aspects of the issue of foreign investment and to propose policy alternatives for the consideration of the Ontario Cabinet. The Task Force was mobilized for two basic reasons. First, the presence of a large degree of foreign investment in the Canadian economy has engendered much concerned public debate and necessitated that governments in Canada make explicit decisions on the problem. Secondly, since the Government of Canada has undertaken a special study, headed by the Hon. Herbert Gray, on the effects of investment from abroad and will prepare and submit recommendations for appropriate Canadian policies, it was felt that the background for such policies as might affect the Province of Ontario should be studied and defined so that the Provincial interest could usefully be presented in the ensuing public debate.

The Task Force was composed of six governmental economists from three departments: the Department of Treasury and Economics, the Department of Trade and Development, and the Department of Financial and Commercial Affairs. A series of meetings were held in late 1970 and early 1971, followed by the preparation, in the Economic Planning Branch, Department of Treasury and Economics, of a draft report.

This Report, amended and adjusted at subsequent meetings, represents the views and best judgement of the members of the Interdepartmental Task Force and is respectfully submitted to the Ontario Government for consideration in the belief that the material is a good first step towards the solution of a very complex problem.

C. Peter Honey

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I. INTRODUCTION

In the intense debate on the role of foreign investment in Canada, the question has repeatedly been asked whether or not reliance on foreign capital and technology is a good thing for this country. Despite valuable research on the subject by a number of economists,* Canadian policy-makers are not yet particularly well informed on the alternatives available to them, primarily because the issue, although economic in nature, is greatly complicated by a vast overlay of political and cultural considerations.

It is difficult to disagree with Raymond Vernon, Professor of International Trade and Investment at the Harvard Business School, who writes on the subject as follows:

> *It should surprise no one that the excellent studies so far produced have failed to provide that flash of revelation which discloses, once and for all, the net effects of the U.S. investment relationship in Canada. If my understanding of the process is valid, any simple model of the sort an economist is capable of producing is too naive to capture the critical long-term effects of such investment. Estimates of that sort, as a number of recent studies in the United States and Britain have shown, involve an extraordinarily complex and involuted series of judgements, guesses and assumptions. If Americans had not invested in manufacturing facilities in Canada, would they have continued to export manufactured products to Canada? If Americans had not invested in raw materials in Canada, would they have invested elsewhere? What would the Canadians themselves have done in the absence of U.S. investment? Would Canadian skills have been lower because the opportunities for their application were less; or would Canadian skills have been greater, because they were not locked in and restrained by the inhibiting influence of U.S. corporate structures?***

Politically and culturally, it may be germane to inquire into the future status of our national sovereignty, given the implications of our substantial reliance on U.S. controlled corporations operating in Canada. It may also be important to examine the effect of the ongoing process of Americanization on Canadians and the extent to which we may forget our place as citizens of a truly distinctive nation.

Unfortunately, many of these issues go far beyond the scope of economic analysis. This report does not pretend to examine all the parameters of Canada's and Ontario's current problems related to investment from abroad. What is presented here is an effort to increase our understanding of the issue and to provide a greater clarification of the basic options which the Government of Ontario may possess before formulating its policies.

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* *Especially A.E. Safarian, A. Rotstein, M. Watkins and other economists who prepared the* **Report of the Task Force on Foreign Ownership and the Structure of Canadian Industry,** *Ottawa, 1968.*

** *Raymond Vernon, "U.S. Enterprise and the Canadian Economy",* **Canadian Forum**, *April 1969.*

II. FOREIGN OWNERSHIP AND CONTROL OF CANADIAN INDUSTRIES

Relevance of Statistics

The extent of foreign ownership and control of Canadian industries is generally known to the informed public, but such knowledge does not necessarily contribute to the attainment of a national consensus on policies designed to deal with the problem. While it is claimed by some that statistical data showing deep penetration of the Canadian economy by foreign-controlled firms are symptomatic of a serious malaise, others suggest that the data do little to clarify what they perceive to be the real issue: the extent to which foreign-controlled firms function in a manner disadvantageous to the Canadian nation and people.

A major body of public opinion does, however, register much concern with the extent of foreign investment in this country. Admittedly, all Western nations look favourably upon capital inflows from abroad, provided they do not get out of proportion to domestic investment. Yet the core of Canadian dispute lies with the unusually large size of foreign investment. It is, therefore, advisable to give some attention to the available statistical evidence to make clear at least the proportions of the problem.

Value of Foreign Investment in Canada

Between 1945 and 1967, the value of all foreign capital invested in Canada increased five-fold, rising from $8.2 billion to $40.2 billion. Growth in Canadian assets abroad was less pronounced, from $4 billion to $15 billion, and as a result of both these trends, the country's net indebtedness increased from $4.2 billion in 1945 to $25.2 billion in 1967.*

Canada's Balance of International Indebtedness
Selected Year Ends, 1945-1967

	Gross liabilities to other countries	Gross external assets	Net indebtedness
		(billions of dollars)	
1945	8.2	4.0	4.2
1957	19.6	7.9	11.8
1960	25.6	8.9	16.6
1961	27.3	9.6	17.7
1962	28.8	10.1	18.7
1963	30.5	10.9	19.6
1964	32.8	12.4	20.4
1965	35.2	12.9	22.4
1966	37.9	13.9	24.1
1967	40.2	15.0	25.2

Note: *As figures are individually rounded, totals do not necessarily equal the sum of their component parts.*

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* *Most of the statistical data in this report are figures from the publications of Statistics Canada, Ottawa. Only when other statistical sources are used will origin of information be indicated in footnotes.*

Preliminary estimates by Statistics Canada indicate that the total of Canada's external liabilities increased to $46 billion by the end of 1969 with the net indebtedness reaching a book value of over $27 billion.

Most of the non-residents' claims on Canadians have been of the long-term type of investment distributed by category of assets as shown below.

Foreign Long-Term Investments in Canada
Classification by type of assets

	1945	1963	1966	1967
		(millions of dollars)		
I. Direct investments	2,713	15,502	19,008	20,699
II. Government bonds	1,662	4,207	5,153	5,813
III. Other portfolio investments	2,433	4,725	5,665	5,759
IV. Miscellaneous investments	284	1,771	2,264	2,431
TOTAL INVESTMENT	7,092	26,205	32,090	34,702

Not only has the overall rise in long-term indebtedness been significant in the post-war period, but also changes in the composition of that indebtedness have occurred, namely an increase in the relative size of direct investment. In 1945, direct investment constituted 38 per cent of the total long-term investment owned by non-residents. In 1967, that proportion was almost 60 per cent.

The Spread of the Multinational Corporation

What the statistics portray as the growth of foreign direct investment is known to represent the establishment of new branch plants and subsidiaries of foreign corporations as well as take-overs of Canadian firms by non-resident interests. The phenomenon can be seen in the growth and spread in Canada of foreign-based multinational corporations.

It should be added at this point that Canadian-based companies have also been active in the process of expanding their operations abroad, but the book value of their foreign holdings has been significantly smaller than that of foreign direct investments in Canada.

Canada's Direct Investment Position

	Book Value of Canadian Direct Investments Abroad	Book Value of Foreign Direct Investments in Canada
	(millions of dollars)	
1945	720	2,713
1957	2,073	10,129
1960	2,467	12,872
1961	3,272	15,961
1965	3,469	17,356
1966	3,711	19,008
1967	4,030	20,699

The impact of foreign-based multinational corporations on the Canadian economy cannot be fully appreciated unless the extent of their control in the various industrial sectors of the economy is also known. Unfortunately, the relevant Statistics Canada data do not go beyond the year 1963.

Foreign Control as a Percentage of Selected Canadian Industries, Selected Years, 1926-1963

	Per Cent Control						
	1926	1930	1939	1948	1954	1958	1963
Manufacturing	35	36	38	43	51	57	60
Petroleum & Natural Gas*					69	73	74
Mining & Smelting	38	47	42	40	51	60	59
Railways	3	3	3	3	2	2	2
Other Utilities	20	29	26	26	8	5	4
Total of above industries	17	20	21	25	28	32	34

* *Petroleum and natural gas combined with mining and smelting for years 1926, 1930, 1939 and 1948.*

In the manufacturing sector, non-resident capital has tended to concentrate in high technology industries and Canadian ownership and control in these industries have been almost reduced to insignificance.

Foreign Control of Selected Canadian Manufacturing Industries, 1963
Percentage of Capital Employed Controlled by Non-Residents

Manufacturing	Per Cent
Beverages	17
Rubber	97
Textiles	20
Pulp and Paper	47
Agricultural Machinery	50
Automobiles and Parts	97
Other Transportation Equipment	78
Primary Iron and Steel	14
Electrical Apparatus	77
Chemicals	78
Other	70
TOTAL	60

While there are no Statistics Canada data for recent years, the annual reports of the Corporations and Labour Unions Returns Act (CALURA) indicate that the growth of foreign ownership and control in the Canadian economy has continued unabated. In the

years 1965-1968, all industrial sectors (with the exception of agriculture, forestry, fishing and trapping) showed rising levels of assets represented by foreign-controlled corporations. (See Table below.)

CALURA figures are not directly comparable to Statistics Canada data. They show, however, not only the same trend of continued expansion of the foreign-controlled sector of the economy relative to the sector controlled by Canadians, but also a growing concentration of non-resident ownership in Canada's major enterprises which have faster growth than small companies. In 1968, there were 276 foreign-owned corporations in the non-financial industries with assets of $25 million or more, representing some 6 per cent of all foreign-owned corporations in the non-financial industries reporting to CALURA. These 276 corporations had combined assets of $27.7 billion or 70 per cent of the assets of all non-resident owned corporations and 28 per cent of the assets of all non-financial corporations — both reporting and non-reporting. The 186 Canadian-owned corporations of this asset size in 1968 represented less than 1 per cent of all reporting Canadian-owned corporations and had assets of $18.0 billion or 43 per cent of their total assets.

Percentage of Assets Represented by Non-Resident Owned Corporations by Industrial Sectors, 1965-1968*

	Non-resident owned Corporations				Assets in 1968 (Millions of dollars)	
	1965	1966	1967	1968	All Corporations	% covered by reporting Corporations
	(per cent)					
Agriculture, forestry, fishing and trapping	8.8	7.7	8.3	6.4	1,080.3	61.5
Mining	57.9	57.5	60.0	62.8	11,720.0	97.8
Manufacturing	55.4	56.4	56.7	58.1	42,163.0	96.7
Construction	9.9	13.0	14.0	13.6	5,199.4	82.1
Transportation, storage, communication and public utilities	6.7	6.8	6.2	7.8	18,957.5	35.9
Wholesale trade	26.7	28.1	28.5	31.4	9,373.3	89.2
Retail trade	17.7	19.1	20.4	21.2	6,815.0	78.1
Services	12.5	15.9	17.3	19.7	4,841.8	73.1
Non-financial Total	36.0	37.4	38.0	39.4	100,150.3	81.1
Finance	11.3	12.1	12.1	12.6	89,764.1	46.4
Total	24.5	25.8	26.0	26.7	189,914.4	64.7

* *Taken from the* **Corporations and Labour Unions Returns Act Report of 1968.** *It is not meant to be compared with the preceding tables on non-resident control. It is included to show general trends in particular industrial sectors up to 1968. In defining foreign*

(cont'd on next page)

After the Second World War, most of the foreign capital inflows into Canada originated in the United States. Between 1945 and 1967, the American share of total long-term foreign investment in Canada increased from 70 to 81 per cent.

Composition of Foreign Long-Term Investments in Canada, by Country of Origin, Selected Year Ends, 1900-1967

(per cent of total value of investments)

Owned by residents of:	1900	1918	1939	1945	1960	1964	1967
United States	14	36	60	70	75	78	81
United Kingdom	85	60	36	25	15	13	10
Other Countries	1	4	4	5	10	9	9
Total Value	100	100	100	100	100	100	100

Because of the predominance of American investment in Canada, the foreign ownership issue has, to a large extent, been defined mainly in terms of American-Canadian economic relations. It is therefore timely to recall the causes and circumstances under which American corporations expanded into Canada.

Historical Background

There are a number of well known reasons for the powerful penetration of Canada by American capital. The United States emerged from the first World War as the world's largest and strongest economic power. It was the first among modern industrial nations to create a market economy based upon the principles of mass production and rapid technological change. In this process, a large and well-functioning capital market was created, and powerful joint-stock companies grew in size and numbers which were capable of developing natural resources and sophisticated technological innovations — not only in the United States, but also abroad.

American capacity and eagerness to expand into foreign markets converged with Canada's foreign trade policy. This country's tariff structure was designed to raise the cost of imported goods so as to afford protection for young domestic industries. American companies availed themselves of the opportunity to get behind the Canadian tariff wall to

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control, Statistics Canada refers to all corporations over which the non-resident owners are in a position to exercise effective control, even if that control is based on less than 50 per cent of the voting stock. Under CALURA definitions, all corporations classified as non-resident-owned must have at least 50 per cent or more of the voting stock owned by non-residents. Important segments of the corporate universe in Canada are exempt from reporting under the Act, because of their small size and because they operate under various Acts governing banking, broadcasting, air and water transportation, railway, telegraph, etc. For details see the CALURA Report for 1968.

set up plants designed to supply Canada's domestic market as well as other British Commonwealth markets. The latter strategy was aimed at benefiting from British preferential import duties if deliveries were made from plants located in Canada rather than the United States.

All this is widely known, but is still not a sufficient explanation. Why was the Canadian economy, as it also grew in size and experience, not capable of reversing the trend towards more and more American ownership and control in manufacturing, mining, oil and gas? The answer might be that Canadian governments never seriously intended to stop that trend or that they did not know other ways of bringing Canada into the industrial era.

According to Professor Vernon:*

> *This blend of reactions on the part of U.S. enterprise to the Canadian economy was nothing that Canada itself sought to discourage. While naturally eager to be master in its own house, it has just as naturally been willing to accept a little help in constructing and improving the edifice. On the whole, barring an occasional exceptional act, U.S. capital was warmly welcomed in Canada. At times the domestic laws of Canada, especially its tax laws, seemed intended to persuade U.S. capital to use Canada as a home away from home. Indeed Canada went even further than that in identifying herself with the U.S. economy. Whenever some sovreign act of the United States threatened to hurt the economy, such as the imposition of quotas on the importation of crude oil or on the exportation of capital, Canada usually pleaded her special relationship with the United States as a reason why her territory should be exempted from the U.S. government's restrictive acts. Supported by a strong American lobby, Canada generally received the special status that she desired.*
>
> *Encouraged by this general policy, American businessmen found Canada extraordinarily attractive. Whenever Canada played the role of independent sovereign, as she did in the imposition of import barriers, the Americans were prepared to take the political risk of producing inside the Canadian market. In fact, American producers in the oligopolistically-structured industries may have felt they had no choice; Canada's propinquity to the United States meant that the process of diffusion and appropriation of the relevant technology would almost certainly have deprived the Americans of their opportunity to export to that market.*
>
> *While Canada's occasional propensity for protecting local manufacturing facilities encouraged Americans to invest in such facilities, her more general policy of maintaining an open economy encouraged the Americans to invest in the exploitation and processing of Canada's abundant raw materials. Here again, the interest of any large producer in a highly concentrated American industry may well have sparked the interest of all the others in the complex business game of matching the opponent's positions of potential strength.*

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* *Op. cit.*

A handful of sectors considered sensitive in Canadian political opinion have, however, not been penetrated by U.S. capital because of stringent laws restricting foreign investment. These sectors include banking, finance and trust companies, broadcasting and communications. Railways and other utilities, such as power plants and electricity networks, also have had very low foreign equity participation due to the establishment of Canadian National Railways and provincially-organized electric power authorities.

All other industries were open to investment by non-residents. This policy, often described as "open-door", has resulted in the gradual but continuous growth of non-resident ownership and control in the Canadian economy. However, Canadian policy stands in stark contrast to much more restrictive policies implemented in the area of foreign investment by the vast majority of Western industrialized nations.

III. OTHER COUNTRIES' POLICIES TOWARDS FOREIGN INVESTMENT

Japan's Economic Nationalism

Japan is the country most often cited as the one whose policies towards investment from abroad have been diametrically opposed to those followed by Canada. From the first days of its industrialization, Japan has travelled the road of economic nationalism. And there is much to suggest that its policies were more instinctive reactions to circumstance rather than the results of explicit cost-benefit calculations. This is openly acknowledged by the Japanese government:*

> *Japan's modernization was carried out to counter the impact of the West. In the nineteenth century, when the influence of European powers moved with increasing momentum toward the East, the Japanese people came to feel that their independence was being threatened. A way of thinking, not in terms of the clan, but in terms of the state, i.e. a national consciousness, was engendered out of this sense of danger. The maintenance of independence thus became, to every Japanese, the most important national purpose. This nationalism enabled the people to transcend the idealogical conflicts that cannot be avoided in periods of violent change.*
>
> *The confrontation between the groups advocating an open-door policy and those advocating the exclusion of foreigners was a bitter one that sharply divided public opinion. It was, however, a confrontation on the question of how best to preserve national independence.*
>
> *It is, of course, doubtful whether the inflow of foreign capital would really have brought about Japan's economic subservience to foreign interests. Indeed, a reasonable degree of foreign investment might well have accelerated economic development.*
>
> *Nevertheless, the major portion of capital required for economic construction had to be raised at home. In this sense, the decision of the Meiji leaders to raise capital by collecting a land tax from the farmers, despite their bare subsistence level, was indeed commendable.*
>
> *In any event, as can be seen in these. . . . examples, if these leaders found certain measures necessary for economic construction, they carried them out however difficult and unpopular they might be. In this way, the energies engendered by a growing sense of nationalism were guided by these leaders with a strong sense of responsibility .*

In early 1969, Japan became the world's third economic power and government regulations restricting investment from abroad have since softened slightly. However, the door seems to

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* **Japan in Transition, One Hundred Years of Modernization,** *Ministry of Foreign Affairs, Japan, 1968, pp. 11, 19.*

have been opened to foreign investors only in those industries where competition with Japanese corporations would now be very difficult, if at all possible.

The general requirement that foreign capital own less than a controlling interest in Japanese companies has often been mentioned by Western investors or would-be investors as the most serious impediment to locating plants in Japan. But there has also been another deterrent to foreign firms — that of too much government control. The Japanese government plays a key role in business: it plans the strategy of industrial development and strictly supervises the implementation of its recommendations. There arises out of this, foreign investors complain, an inability to implement their own business policies.

Japan is doubtless an extreme case of a country pursuing very rigorous nationalistic policies towards investment from abroad. Most other Western countries also try to prevent foreign investors from assuming too powerful a position in their economies.

The Scandinavian Countries

In Sweden, foreign companies need government permission before setting up any enterprise. As in most other European countries, foreigners cannot operate businesses dealing in mining, real estate, railways, telephones, television or radio systems. Foreigners, including Swedish foreign-owned companies, need special governmental permits to acquire real estate, waterfalls and mineral resources. In practice, however, the permit to acquire natural resources, such as forests and mines, cannot be obtained. Permission is always refused when there is reason to suspect that speculation in property values might occur. With respect to renting and leasing property, non-Swedish nationals are generally not discriminated against.

The other commonly cited obstacles to foreign investment in Sweden concern government regulations over the management of foreign-owned enterprises. According to these regulations; the managing director and all members of the board of directors must be residents and nationals. Under the Swedish Companies Act, a waiver may be granted permitting as many as one-third of the directors to be foreigners, and attempts have recently been made to further modify these requirements, but special governmental permits allowing deviation from the general rule are still required.

In Norway, foreign enterprise is prohibited from investing in natural resource development and restrictions are imposed on ownership of real estate. However, there seem to be fewer government restrictions on foreign investment for the purpose of offshore oil and gas exploration. As in other Scandinavian countries, special permission must be obtained from the central government for all direct investment from abroad and there exists a legal requirement that at least half of the foreign subsidiary's board of directors be residents of the country.*

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* *Most of the information for this chapter has been obtained from:* **Obstacles and Incentives to Private Foreign Investment, 1967-68**, *The National Industrial Conference Board, New York, Business Policy Study No: 130.*

Other West European Countries

As far as natural resources are concerned, the problem of foreign ownership and control does not exist in most European countries. Coal mines have either been nationalized (United Kingdom, France) or have been firmly held by domestic mining companies (West Germany). In France and Italy, natural gas exploration and production has been in the hands of state-owned energy concerns, Gaz de France and ENI (Ente Nazionale Idrocarburi).

In the Netherlands, where large deposits of natural gas were found in 1959, a consortium under the name of Nederlandse Aardolie Maatschappij (NAM) is in charge of the operation. It is owned equally by the Royal Dutch Shell Oil Company and the Standard Oil Co. of New Jersey, but the Dutch government has a strong, if not decisive, voice in setting the pricing policies for the gas produced.

Exploration for petroleum and natural gas in the British sector of the North Sea has been conducted by more than 25 British, foreign and international consortia, and a number of gas fields have already been brought into production. All deliveries of gas, however, must be made to the Gas Council, a governmental agency composed of 12 area gas boards, and this agency has the exclusive right to purchase natural gas for distribution.

In manufacturing, merchandising and services, foreign investment is allowed in most West European countries, but it is subject to more or less restrictive governmental supervision.

The mix of policies designed to regulate investment from abroad is different in each country. There are more nationalistically-minded countries, such as France, and more liberally-minded, such as West Germany (at least for the time being). Present policies, however, seem to suggest that foreign investors are welcomed, provided they do not assume positions of strength which could lead to the domination of key industries or which could effectively frustrate independent national policies.

In most countries, permission must be obtained by foreign investors from the government in order to set up subsidiaries. The policies pursued in treating applications are generally flexible — even in France. At present, the French government keeps the door half-open. New manufacturing facilities proposed by foreign companies are welcomed, but bids for take-overs of domestic companies are treated differently. The French government prefers internal mergers to acquisitions by foreigners. It may give permission to set up plants in selected areas, e.g., in the Marseilles area or the Ardennes, but not in the overpopulated Paris region or the industrialized north. All major investments from abroad, whether in the form of new plants or take-overs of French companies, have to get prior approval from the Ministry of Finance, and this form of supervision allows the French government to control the direction of structural changes in domestic industries.

The practice in recent years has been that foreign bids for take-overs of large French companies were refused, while permission for the acquisition of firms having minor shares of the domestic market was granted. The policy on foreign investment has, thus, been very much a part of other policies on industrial competition and rationalization.

In Britain, the Industrial Reorganization Corporation has been instrumental in blocking a number of major foreign take-overs. Although its activities centred much less on restrictive moves than on sponsoring mergers among British companies, it was, nevertheless, guided by the principle that the nation should retain a strong presence in all major manufacturing industries.

Trend Towards Nationalism Throughout the World

Harold B. Scott, United States Deputy Assistant Secretary of Commerce, speaking to the Annual Conference of the Canadian Importers' Association in March 1971, admitted with regret that there is a growing trend to nationalism throughout the world, based on an emotional reaction to foreign investment and a fear that decisions taken in other countries may adversely affect local interests. It may be useful to review briefly the forms which this nationalistic trend assumes in developing countries.

Mexico seems to have developed a relatively simple, but stringent, set of rules restricting investment from abroad. No foreign investment is allowed in five exclusively state-controlled sectors (oil, basic petrochemicals, electricity, railroads, and telegraphic and radio-telegraphic communications), nor in the eight sectors restricted to 100 per cent Mexican-owned companies (credit institutions, insurance companies, bonding companies, investment companies, radio and television companies, automotive transportation on federal highways, gas distribution, and forestry exploitation).

Twenty other sectors are reserved for companies with majority Mexican capital (minimum 51 per cent):

fishing and fish-breeding;
sea-food packing plants;
mining;
secondary petrochemicals;
basic chemicals;
rubber manufactures;
steel;
cement;
glass;
fertilizers;
cellulose;
aluminum;
food processing and packing;
publication of books and magazines;
production and distribution of soft drinks;
production, distribution and exhibition of movie films;
publicity and propaganda;
urban and inter-urban transportation;
maritime transportation, and air transportation.

Steel, cement, glass, fertilizers, cellulose, and aluminum industries were added to the list of sectors requiring Mexican majority ownership in 1970. The decree limiting foreign capital participation in these industries provides that Mexicans or Mexican corporations shall hold a majority share of capital in firms classified under these industries, and that such firms shall be administered principally by Mexican citizens.

In the past, Mexico has been regarded as unique in Latin America for its insistence on national control of all major domestic industries. Recently, a number of other countries on

that continent have taken steps to follow the Mexican example. In an agreement ratified on June 30, 1971, the members of the Andean Pact — Colombia, Chile, Peru, Bolivia and Ecuador — outlined a common policy on foreign investment. This policy is scheduled to be implemented gradually, over a period of 15 to 20 years. After that time, certain basic service industries, such as the public utilities, banking, insurance and transport, and certain types of heavy industry, such as steel and metal refining, will be forbidden altogether to foreign investors. In everything else, foreigners will be allowed to participate to the level of 49 per cent. The repatriation of profits and capital in any year will be limited to 14 per cent of capital employed. In return, foreign investors will obtain certain guarantees, access to foreign exchange for the remittances they are allowed, and due compensation if and when they are expropriated.

In British circles, the Andean Pact Agreement has been welcomed as preferable to the irregular pattern of nationalizations in a number of South American countries which struck at foreign-controlled copper and iron-ore mines, oil fields, financial institutions, and agricultural land holdings. It must be remembered, however, that the provisions of the Andean Pact Agreement represent minima, and that the nationalistic regimes of Peru, Bolivia and Chile may require the minimum local participation well before the 15-year deadline.

Other examples of economic policies with various degrees of bias against foreign control can be cited, especially from Arab nations, India, Guyana, and the Carribean Islands. Unfortunately, the circumstances in these countries do not provide good parallels to Canadian problems. However, the direction of governmental policies in Australia is of considerable interest. Foreign investors express the view that the Australian economy is going through a "nationalistic phase". There is considerable pressure for 50 per cent domestic ownership of any enterprise, but the urging for local participation applies mainly to the extractive industries. Still, there seem to be frequent cases where a figure well below 50 per cent local participation is regarded as acceptable. However, foreign-controlled Australian subsidiaries are prevented from borrowing on the domestic market unless advance approval is obtained from the Federal Treasury Board and from the responsible Minister; this is not easily secured.

It would lead us too far to try to describe the extremely complex picture of laws, regulations, and policies pursued by various governments in their endeavour to promote national growth with as little cost to national independence as possible. Canada's case is unique in that this country has so far systematically rejected economic nationalism even in its moderate forms. The conviction has prevailed that any restrictions on the inflow of foreign capital would seriously impair the country's economic growth and the prosperity of its citizens. There is no doubt, indeed, that Canadians have reached a high standard of living, but there is not much evidence to the contrary to suggest that countries practising a fair degree of economic nationalism have not also been successful in this endeavour.

IV. FOREIGN INVESTMENT AND ECONOMIC GROWTH

Economic growth is a function of investment. Naturally, then, investment from abroad also falls into the category of factors that encourage growth. The short-term effects of foreign capital inflows are, however, very often confused with their long-term impact on the economy. Frequently in attempting to solve current problems of unemployment, political leaders openly seek direct investment from abroad, presumably free of doubt that their action will also be beneficial in the long run. The net effect of inflows of foreign capital is, however, far from simple. Infusions of direct foreign capital may, for example, occur at a time when the economy is operating below capacity. Change of ownership and control of an enterprise brought about by a take-over will, then, not necessarily result in increased production or improved efficiency.

One may also ask whether or to what extent investment by foreign corporations supplements the initiative of locally-owned businesses, or whether and to what degree it merely replaces local initiative. Once a high degree of foreign control over a country's domestic industries has been reached, substantial financial transfers abroad may occur representing profits, royalties, licence fees, or withdrawal of amortization funds. If this occurs, the original capital inflow reverses itself and becomes a financial outflow. This, in turn, may have the effect of restraining the host country's investment and its rate of economic growth.

In Canada, the belief is widespread that the presence of multinational corporations on our soil has contributed to our vigorous economic growth and our high standard of living. As stated earlier, this very complex problem is not easily quantifiable, but we should at least try to examine the relationship between what we might call "the degree of reliance on capital from abroad" and the rate of economic growth. Owing to the preponderance of U.S. capital in international investment, it may be sensible to attempt to determine the existence of any correlation between the level of U.S. direct investment in a given country and its rate of economic growth.*

Canada and the Geographic Distribution of U.S. Direct Investments Abroad

Over the period 1945-1968, Canada had more U.S. direct investment than all of Europe and substantially more than the whole of Latin America. Only recently, in 1969, has the book value of U.S. direct investments in Europe exceeded the value of U.S. investments in Canada.

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* *The OECD estimate of the book value of foreign direct investments of industrial countries in 1966 was $90 billion, of which $55 billion, or 61 per cent of the total, constituted the U.S. share. Of the non-U.S. total of $35 billion, $16 billion was British, and $3.2 billion Canadian.*

Book Value of U.S. Direct Investments Abroad, by Major Areas

	1960	1965	1968	1969
		(millions of dollars)		
All Areas	31,865	49,474	64,983	70,763
Canada	11,179	15,318	19,535	21,075
Europe	6,691	13,985	19,407	21,554
Japan	254	675	1,050	1,218
Australia, New Zealand and South Africa	1,195	2,334	3,508	3,854
Latin America	8,365	10,886	13,101	13,810
Other Areas	4,181	6,276	8,383	9,250

Source: U.S. Department of Commerce, **Survey of Current Business**, *October 1970.*

For the purpose of drawing more detailed inferences, it may also be useful to indicate the value of U.S. direct investments in selected European countries.

Book Value of U.S. Direct Investments in Selected European Countries

	1968	1969
	(millions of dollars)	
United Kingdom	6,694	7,158
Germany	3,784	4,252
France	1,904	2,091
Switzerland	1,437	1,606
Italy	1,275	1,423
Netherlands	1,069	1,218
Belgium	981	1,210
Sweden	516	604

Source: U.S. Department of Commerce, **Survey of Current Business**, *October, 1970.*

The above figures indicate that the geographical distribution of U.S. direct investments abroad has been very uneven. The unevenness is even more striking when the value of U.S. direct investments is calculated in proportion to the host country's population.

Book Value of U.S. Direct Investments in Selected Countries Per Capita of Host Country, 1968

(dollars)

Canada	940	Sweden	65
Switzerland	234	Germany	63
United Kingdom	121	France	38
Belgium	102	Italy	24
Netherlands	82	Japan	10

If, as is widely believed, the contribution of foreign capital to a country's investment level comes "on top" of the domestic investment effort, then we should expect that those countries which have had the benefit, over the last one or two decades, of large direct investment inflows from abroad should also have shown substantially higher rates of economic growth than countries relying principally on their own sources of investment.

This common belief, however, finds little empirical support with respect to economically advanced countries.

Canada's Growth Performance

An investigation into post-war rates of growth appears to indicate that countries which have been relying principally on their own developmental resources have been not only as successful as Canada, Switzerland, and the United Kingdom in generating growth — but even more so.

Average Annual Rates of Growth of Real Gross Domestic Product, Selected Countries*

(per cent per year)

	1950-60 (actual)	1960-70 (estimated)	1970-80 (projected)
Japan**	8.4	11.3	10.0
West Germany	7.9	4.7	4.6
Italy	5.5	5.7	5.6
Netherlands	4.6	5.1	4.6
France	3.5	5.6	6.0
Canada	3.9	4.9	5.4
Switzerland	4.2	4.2	3.3
Sweden	3.6	4.5	3.6
Belgium	2.8	4.7	4.7
United Kingdom	2.7	2.7	3.2

* *Ranking of countries according to average performance in the period 1950-70.*

***Gross National Product at constant market prices. First period 1952-60 instead of 1950-60.*

Sources: **United Nations Yearbook of National Accounts Statistics 1968**, *Vol. II*

OECD, **The Outlook for Economic Growth, a summary report on experience, prospects and problems of policy 1960-1980**, *May 1970.*

The case of the United Kingdom is of particular interest. For most of the post-war period, Britain had more U.S. direct investment than all of the countries which are now members of the European Common Market taken together. Still, the high level of investment from abroad and Britain's deep involvement in foreign-based multinational operations have not prevented her from recording one of the lowest rates of growth among OECD countries. It is certainly not implied here that the degree of reliance on investment from abroad is the principal factor that determines the rate of economic growth. But it is suggested that the post-war experience does not supply the evidence that an open-door policy on foreign investment will give the host country a long-run advantage in terms of economic growth.

Canada's growth performance has been no better than average among OECD countries, and this may well indicate that we have been witnessing a weakening of the indigenous Canadian investment effort. Since capital has been flowing in from the United States, there has been less pressure on Canadians to generate savings internally, to tighten belts in order to maintain, out of our own resources, a satisfactory level of productive investment. Perhaps it is that we Canadians have lived beyond our means while most other nations have had to make sacrifices in their levels of consumption in order to generate funds for investment domestically.

This may be part of the truth. Expenditure for infrastructure may also have been higher in Canada than in the smaller, more densely populated countries. But does all this explain the fact that between 1945 and 1969 Canada's international net indebtedness increased by $23 billion, while the results in terms of growth have been no more than average? Likely not.

Thus, there appears a necessity for a re-evaluation of the whole economic framework within which the savings of Canadians and their organizational and entrepreneurial talents are put to use in the pursuit of economic and social goals.

The "Growth" versus "Development" Issue

Joseph Schumpeter's classical work *The Theory of Economic Development* proposed a basic distinction between economic development and economic growth. In the Schumpeterian sense, the mere growth of an economy, as shown by the growth of population and wealth, cannot be defined as a process of development. By "development" Schumpeter referred only to those changes in economic life that are not applied from without but arise from independent initiative, from within. Entrepreneurial initiative and innovation were thus labelled as the fundamental phenomenon of economic development. "Innovation" means the introduction of a new or improved product or service, a new method of production, the opening up of a new market, a new source of supply of raw materials, the introduction of new schemes of business organization, including the creation or breaking up of monopoly positions.

For the entrepreneur, innovation leads to a temporary monopoly in the market enabling him to collect profit as a temporary "quasi-rent". There is no entrepreneurial profit without development, and no development without profit. Moreover, because profits arise solely from innovation, innovation is the origin of the accumulation of wealth. The entrepreneurial

function is not only the vehicle of continual re-organization of the economic system but also the vehicle of continual changes in the elements which comprise the upper strata of society.*

The Schumpeterian theory of development has been applied by Professor Kari Levitt in her analysis of Canadian problems. In *Silent Surrender,* Levitt presents an appraisal of Canada's economic leadership capacity. The following is our interpretation of her views:**

> Since the Canadian economy has become a branch plant economy, the indigenous entrepreneurial class has been increasingly stultified and converted into a complacent class of managers acting on behalf of the absentee decision-makers. The entrepreneurial function in the modern multinational corporation is vested with the general executives in the head office. Development of ideas that will justify the investment of capital, allocative decisions with respect to research and development and the establishment of new plants, decisions on the use of retained earnings and their geographical application, all these are entrepreneurial functions within the exclusive scope of responsibility of the general executive.
>
> The executives of Canadian and other foreign operations of American companies are managers, not entrepreneurs. They do not make the guiding decisions concerning the global goals of the enterprise or the allocation of money; they operate within the guidelines set down by the general office. Any subsidiary is always the chosen instrument of its parent company. Its very reason for existence is to carry out the functions of the parent in its designated sphere of activity, and it must recognize this relationship in all its actions.
>
> Since an innovative economy with strong entrepreneurial functions and a rapid pace of technical progress will be able to reap the benefits of venture profits, a financial basis will be created for more investment and more economic growth. Canada, however, has a derivative or imitative economy, and she has to pay for most of the innovative processes brought in from outside. The fact that she has high standards of education does not help her too much, because most of the research and development activities are located at the foreign-based headquarters of the multinational corporations.
>
> Canada has resigned itself to perpetual dependence on external initiatives. Canadian business has opted to exchange its entrepreneurial role for a managerial and rentier status, and Canada has regressed to a rich hinterland with an emasculated, if comfortable, business elite. Canada has become the world's richest underdeveloped country and Canadians may soon find out that their riches are temporary.

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* *See Joseph A. Schumpeter,* **The Theory of Economic Development***, (Cambridge, 1934), Chapters II and IV.*

Kari Levitt,* **Silent Surrender — the multinational corporation in Canada, (Toronto, 1970), pp. 27, 28.*

Some may dispute Professor Levitt's views on Canada's dependence on external initiatives, or even dismiss the whole Schumpeterian theory of economic development and growth. In our opinion, however, it is of paramount importance that Canada, as a sovereign nation, preserve and expand the indigenous entrepreneurial function which is basic to providing the country with independent economic leadership, the more so since Canada's economic prospects for the next ten years are not as bright as we might wish them to be.

In 1966 and 1968, Canada ranked fourth in the world in terms of material standard of living as measured by the per capita GNP.

Gross National Product Per Capita

(U.S. dollars)

	1966		1968
United States	$3,520	United States	$3,980
Sweden	2,270	Sweden	2,620
Switzerland	2,250	Switzerland	2,490
Canada	2,240	Canada	2,460
New Zealand	1,930	France	2,130
Australia	1,840	Australia	2,070
Denmark	1,830	Denmark	2,070
France	1,730	New Zealand	2,000
Norway	1,710	Norway	2,000
West Germany	1,700	West Germany	1,970

Source: **World Bank Atlas,** *1968 and 1970.*

OECD's productivity projections for 1980 indicate, however, that Canada will have the lowest productivity increase among member countries.

Productivity Index 1980 (1970=100)

Japan	236
France	169
Italy	159
West Germany	154
Finland	151
Belgium	150
Norway	149
Austria	148
Denmark	144
Netherlands	141
Sweden	137
United States	134
United Kingdom	133
Switzerland	132
Canada	130

Source: OECD, **The Outlook for Economic Growth, a summary report on experience, prospects and problems of policy 1960-1980,** *May 1970.*

In the long run, growth in material standards of living, as expressed by per capita GNP (at constant prices), is always determined by growth in productivity. While Canada's average annual rate of growth in real gross domestic product is expected to approximate 5.4 per cent between 1970 and 1980, a large part of that growth will arise merely from increases in employment. However, to maintain Canada's ranking in terms of per capita GNP among industrial nations, a larger growth in productivity would be required than that forecast by OECD for the coming decade.

Estimates for the next decade suggest that productivity in Canada will grow by 30 per cent, equivalent to a compound average annual rate of 2.66 per cent. It must be stated that these projections may be somewhat optimistic, given a productivity increase of 1.5 per cent in 1968, 1.3 per cent in 1969, and 1.1 per cent in 1970. If we fail to attain higher rates of productivity growth than those projected, it is eminently possible that, by 1980, at least half a dozen OECD countries will have material standards of living superior to that of Canada.

In view of these prospects, the question must be asked whether we do not delude ourselves by believing that we can retain one of the highest standards of living in the world by relying on imported technology, imported entrepreneurship, imported economic initiatives, imported trade marks, and imported patents and licenses. Will we be able to compete in manufactured products without bringing genuinely Canadian products and processes into the world market, under Canadian patents and trade marks? These questions should cause us to give thoughtful consideration to the distinction between economic growth and economic development, and to increase Canada's direct responsibility for its own economic progress.

V. ADVANTAGES AND DISADVANTAGES OF FOREIGN DIRECT INVESTMENT

The beneficial effects of foreign direct investment to the economy of the host country are generally associated with the fact that (at least in certain countries) such investment represents a simultaneous infusion of capital, technological and managerial know-how, supported by the marketing facilities of powerful corporations which operate internationally. For developing countries, direct investments by foreign corporations are often the only way of generating economic growth because these countries not only lack a sufficient supply of capital but, more importantly, do not possess the technology, the managerial know-how and, often, not even the skilled labour force needed to man modern industrial operations.

A Degree of Multinational Presence Always Desirable

A certain level of foreign direct investment from abroad will also benefit highly developed countries by providing competition for domestic industries and by preventing such industries from becoming overly complacent. Multinational corporations have a number of competitive advantages over their national rivals and their presence will, in proper conditions, stimulate the rationalization of domestically-owned industries. These advantages are generally known to extend over production, marketing, research and development, finance, and technical and managerial know-how. Since production facilities of a multinational firm are spread over several countries, there is more scope for specialization of plants and, consequently, for greater economies of scale. This, of course, presupposes the existence of markets which are large enough to absorb the specialized output.

The marketing advantages of multinational corporations stem from two factors. First, in at least those cases where there is a significant degree of vertical integration in an industry (oil, automobiles, steel), the multinational firm has large sales organizations at its disposal. Secondly, the larger the firm's turnover, the smaller the risk involved in new product and brand launchings. The multinational company may, consequently, have a faster pace of innovation. Innovation may also be facilitated by spreading research and development expenditures over large turnovers. In technologically sophisticated industries, such as the computer industry or the aerospace industry, the spread of research and development outlays over a large sales volume is, indeed, the *sine qua non* of success in bringing new products to the market.

The multinational's further advantage lies in its ability to tap a wider range of sources of finance compared with its national rival and to move the required financial resources more or less easily across national boundaries. Finally, the multinational firm derives much strength from an accumulated wealth of experience gained under a variety of conditions in many parts of the globe. This feature of the corporation which is operating internationally is of considerable importance, and the governments of some countries appear to place more faith in the expertise of foreign-controlled companies than in that of domestically-owned firms.

There are thus considerable benefits to be derived from having some representation of foreign-based multinational corporations in domestic industry. Their presence can provide a

powerful competitive stimulus since many multinational corporations act as pathbreakers for technological as well as organizational change affecting indigenous industries. Where they dominate a sector, of course, this catalytic role may no longer be served, and, as later discussion reveals, serious problems begin to appear.

Danger to the Survival of Local Firms

The arrival of giant multinationals on a large scale may threaten the existence of local firms, and national governments have generally not been inclined to acquiesce in the disappearance of domestic ownership and control of entire industries. To prevent an erosion of domestic control in the economy, policy measures have been adopted in many countries, especially in Western Europe, designed to counter the impact of U.S. based multinationals. Among these official initiatives, the government-sponsored rationalization of domestic industries has played a prominent role.

It has also been recognized that many of the competitive advantages of the multinational firm derive from size and not from "multinationalism" per se. The West European response to the American challenge has consisted of creating giant national firms which can reap the fruits of size in the form of economies of scale. The philosophy behind the West European merger activity of the last five years has been that large national firms can be expected to match the performance of multinational firms, provided that they can operate in a competitive environment on large markets. The strategy of Japan's industrial development is based on a similar premise, namely that its large manufacturing companies can outperform foreign competitors, despite Japan's limited participation in transnational production.

Local Funds Financing the Foreign-based Corporation

The seductive attractiveness of economic growth generated by direct investment from abroad seems to stem from two basic factors. First, it is recognized that capital does not need to be accumulated domestically and thus inhabitants of a host country are not required, at least initially, to reduce current consumption. Secondly, there is an almost irrestible temptation to generate growth by simply inviting those from abroad who have the know-how, the experience and the risk capital to establish new ventures or to seize control of weaker domestic companies.

This painless route to economic growth by relying on the knowledge, the organizing skills, and the entrepreneurial talent available in other nations may finally lead to a situation where the people of the host country do not need to have such skills themselves. In the long run, of course, reliance on others for economic leadership may have injurious effects on the capacity of a host country's business elite.

However, the belief that, in developed countries, direct investment from abroad comes as a full complement of capital, together with technology and entrepreneurship, is, to a large extent, a contemporary illusion. According to J.-J. Servan-Schreiber, U.S. corporations have established subsidiaries in Europe with as little as 10 per cent of the capital needed;* the

* *J.-J. Servan-Schreiber,* **The American Challenge,** *(New York, 1969), Part I, Chapter II.*

rest was obtained on European capital markets in the form of long-term borrowings. It seems logical, then, to conclude that the advance of U.S. business in Europe has been due much more to American technological and managerial know-how than to substantial infusions of capital. As Servan-Schreiber indicated, U.S. business has been buying up European industry with European money. Likely, it is this characteristic of the investment process that has induced Australians to impose restrictions on domestic long-term borrowing by foreign-owned companies in order to prevent feared shortages of capital for the use of Australian-owned firms.

In Canada, only 10 per cent of funds absorbed by U.S. owned affiliates in the period 1963-68 came as new inflow from the United States, whereas approximately 86 per cent was generated in Canada.

Sources of Funds of U.S. Owned Affiliates in Canada, 1963-65, 1967-68

(millions of dollars)

	1963	1964	1965	1967	1968
Net Income	675	863	852	925	1,027
Depreciation and depletion	552	623	681	800	864
Funds from the United States	168	156	551	242	127
Funds obtained in Canada	241	307	497	423	539
Other Sources	29	88	75	138	53
Total Sources:	1,666	2,038	2,656	2,527	2,611

Source: "Sources and Uses of Funds of Foreign Affiliates of U.S. Firms, 1967-68", **Survey of Current Business,** *November 1970.*

The same table converted into percentages shows the following picture:

Sources of Funds of U.S. Owned Affiliates in Canada, 1963-65, 1967-68

(per cent of total)

	1963	1964	1965	1967	1968
Net Income	41	42	32	37	39
Depreciation and depletion	33	31	26	32	33
Funds from the United States	10	8	21	9	5
Funds obtained in Canada	14	15	19	17	21
Other Sources	2	4	3	5	2
Total Sources:	100	100	100	100	100

The Honourable Herbert Gray, Chairman of the federal Task Force on Foreign Investment, noted on the subject in April 1970 that "a great deal of accumulated 'foreign' investment in Canada really is the plowed back earnings, borrowings and depreciation earned in Canada by foreign-owned companies — in effect capital which was earned or raised in Canada". Given the universally limited potential of any country to generate savings, Canada's credit

institutions now have to serve the very strong foreign-controlled sector of the economy as well as the domestically-controlled sector.

The gradual replacement of resident ownership of industries by non-resident ownership is, naturally, not a simple matter of substitution. Foreign-owned investment constitutes a sort of debt which needs to be serviced, and Canada's payments of interest and dividends have already reached relatively high dollar values.

Current Payments by Canada of Interest and Dividends, All Countries, 1959-1969

	Millions Of Dollars	Per Cent Of GNP
1959	671	1.9
1960	653	1.7
1961	770	2.0
1962	794	1.9
1963	860	1.9
1964	1,010	2.0
1965	1,086	2.0
1966	1,140	1.9
1967	1,211	1.8
1968	1,259	1.8
1969	1,345	1.7

In addition to dividends and interest, there are payments of royalties for patents, licences, head office expenditure and research and development outlays of parent companies. The current annual estimate of all the "service charges" on the use by Canada of foreign capital is now over $2 billion. These outflows, while they may have declined slightly in relation to GNP, have been increasing in absolute amounts and suggest a continuously expanding base of foreign-owned equity which must be *serviced*, at least potentially, in perpetuity. It is, therefore, in Canada's interest to find ways of reducing long-term commitments of this kind while at the same time mobilizing Canadian savings for Canadian investment uses.

Decision-making Moving Abroad

The large-scale spread of multinational corporations is a relatively recent phenomenon and there is no universally accepted theory on the economics of the multinational corporate system. Studies by institutionally-minded economists indicate that the behaviour of the multinational firm is basically characterized by:

- the concentration of basic decision-making in the parent company;

- the concentration of the bulk of research and development activities in the parent company;

- a tendency to grow to large size and to reduce risk by widening the scope of corporate planning through stretching control to sources of raw materials, and expanding into the marketing of finished products;

- the desire to keep full ownership and control of branch plants and subsidiaries;
- endeavours to favour imports from affiliates often to the detriment of competitive local sources of supply;
- a tendency to consider subsidiaries merely as instruments serving the profit objectives of the corporation as a whole;
- capacity for manipulating intra-company prices in trade between the parent company and affiliates, and for influencing profit reporting in branch plants and affiliates with the objective of moving the locus of profit accumulation to the parent company.*

If these tendencies are inherent to the operations of many multinational corporations and are not counter-acted by Canada's laws and regulations, much concern is justified not only about this country's economic independence but about the economic benefits Canadians expect to derive from the subsidiaries of foreign-based corporations.

Intra-Firm Pricing in Multinational Corporations

The contribution of foreign investment to a country's economy is generally defined in terms of the wages and salaries paid to employees of foreign-owned affiliates, and the corporate taxes paid to host governments. However, the possibility that intra-company prices can be manipulated, and that the foreign-based parent is, for the multinational corporation, the preferable locus of profit accumulation may cast some doubts on the belief that Canada is receiving an equitable share of taxes paid by multinational corporations operating on her soil.

There are several reasons why a multinational corporation may prefer to show higher profits in the parent company. Shareholders in the parent company will more easily be persuaded to accept lower dividend pay-outs if they are compensated through value appreciation of their stock caused by attractive price-earnings ratios. For the management of the corporation, lower dividend pay-outs have the effect of increasing the funds for self-financed reinvestment.

The behaviour of the multinational corporation may also be influenced by the fear that the reporting of high profits in host countries might attract accusations of exploitation, leading to higher corporate taxes, withdrawal of concessions, or even nationalization. Furthermore, minority shareholders of subsidiaries in the foreign country might begin to mobilize pressure for earnings distribution. This latter prospect likely accounts for the demonstrated preference of multinational firms for wholly-owned subsidiaries.

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* *Much information on that subject and guidelines on corporate behaviour are contained in a survey by the Conference Board:* **Intercompany Transactions in the Multinational Firm**, *Managing International Business, No. 6, New York, 1970. Another valuable source:* **The Growth and Spread of Multinational Companies,** *The Economist Intelligence Unit, QER Special No. 5, October 1969.*

Finally, where an affiliate is in the position of supplying raw and fabricated materials to the parent company, while the latter covers a portion of its demand for these materials from outside sources, the parent company may prefer to pay its subsidiary lower prices to influence the level of prices for raw materials bought from outsiders. From the standpoint of the multinational corporation, it does not matter much that a subsidiary may fail to show substantial earnings. The affiliate could appear to lose money, yet contribute to the parent company's profits via intrafamily purchases and sales, license and management fees, interest and royalties, and charges for research and other services rendered by the parent.

Indeed, Professor Levitt argues that these potential tendencies have come to fruition in Canada:

> *In the decade 1950 to 1960 direct investment in manufacturing subsidiaries in Canada was very heavy. The total number of companies engaged in manufacturing in Canada rose from ten thousand to seventeen thousand. The percentage of manufacturing output controlled by foreigners rose from 50 per cent to 60 per cent over the decade. The percentage of loss companies rose from 26 to 31 per cent. The rate of profit after tax fell from 9.5 per cent to 4 per cent.* *

It thus seems to be correct to assume: first, that the multinational corporation has much scope for manipulating intra-company prices and the profits of its subsidiaries; secondly, that it may have the tendency to consider the parent company as the preferable locus of profit accumulation.

Admittedly, the behaviour of the multinational firm may be mitigated by its desire to have a suitable political climate in countries hosting its subsidiaries. But to put faith in the goodwill of the multinational corporation, and to safeguard the country against possible abuses of the economic power wielded by such corporations, are two very different things. Governments should at least be wary of foreign-controlled subsidiaries which continue their operations for many years while reporting, for taxation purposes, unusually low profits or even losses.

The Issue of Extra-territoriality

The goal of the multinational corporation to maximize profits in the long term and expand operations globally is generally not regarded dangerous in itself to the economy of the host country. However, the tendency inherent in the multinational firm to favour the parent company as locus of basic decision making, profit accumulation, and main research and development activities, is of considerable concern. While a number of multinational corporations may have adopted the principle of "equity" in relations with their subsidiaries abroad, a great many firms pursue the policy of treating their foreign affiliates merely as profitable instruments for serving the main body at home. These attitudes have been described in a survey conducted by The Conference Board:**

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* *Op.cit., p. 87.*

****Intercompany Transactions in the Multinational Firm**, *A Survey by The Conference Board, Managing International Business No. 6, New York, 1970, (p. 6).*

The Vice President for international planning in a major electronics company believes the over-all benefit to the corporation is the key consideration, but he doubts that such a policy can be maintained, given the prejudices of top corporate management in the U.S.:

While considerable lip service is given to objectivity and multinational viewpoints, in practice I believe most managements still tend to feel more comfortable when assets are available in U.S. dollars, preferably lodged within the boundaries of the U.S. I make this point because, theoretically, decisions on transfer pricing should be based on where and when it is most advantageous to take the profit on a transaction without regard to national boundaries ....

The longer it takes in any transaction to convert from another currency into dollars — whether this is through collection of receivables, through shipment of domestic merchandise, through royalties and fees from abroad, or through dividends from a foreign subsidiary — the greater the chance for erosion. Therefore, **given a choice** *(our emphasis), in any transfer-pricing policy, the bias will be in favour of a pricing formula and mechanics that put the most dollars in the bank in the U.S. in the shortest time.*

The tendency of the multinational corporation to consider its foreign subsidiaries as something other than fully-fledged profit-making entities should, naturally, be a source of concern for Canada's fiscal authorities. The limited involvement of Canadian subsidiaries in the research and development undertaken by multinational corporations should be viewed even more seriously.

Moreover, the behaviour of the multinationally-operating but nationally-owned and controlled U.S. corporation is subject to external pressures, among which the policies of the U.S. Government play a decisive role in determining the behaviour of U.S. subsidiaries abroad. U.S. jurisdiction is founded on the notions of jurisdiction based on territory, and jurisdiction based on nationality. According to the latter approach, a U.S. controlled company anywhere in the world is treated as a corporate American national, and is consequently subject to U.S. laws, regulations and guidelines.

Such extra-territorial application of U.S. laws has generally been of much more concern to Canadian governments than the internal, essentially private motivation of U.S. based multinational corporations. In the past, the controversy between the Canadian and American governments is known to have evolved mainly around the application to Canadian subsidiaries of the following U.S. laws or guidelines:

1. Trading With The Enemy Act of 1917; and the Cuban Assets Control Regulations;

2. The Sherman Act and the Clayton Act, as well as other U.S. anti-trust laws and regulations;

3. Voluntary or mandatory guidelines to American companies suggesting a kind of behaviour of their foreign subsidiaries that would bolster the U.S. balance of payments.

Whereas the application of the Trading With The Enemy Act has, by and large, not been much more than an irritant in American-Canadian relations, substantially more economic significance has always been ascribed to anti-trust laws and investment guidelines applied to Canadian affiliates of U.S. corporations. The Canadian economy certainly needs rationalization, but U.S. anti-trust laws impose serious restraints on possible Canadian measures to stimulate industrial development and productivity by sponsoring mergers of companies.

As far as the U.S. balance of payments guidelines are concerned, Canada has had to seek exemption from their applicability in order to avoid a domestic investment crisis. The special status has been granted to Canada, but it has not lessened our vulnerability to decisions taken by the U.S. Government.

The role of the U.S. Treasury in shaping inter-company transactions within U.S. controlled multinational firms has been much less debated in Canada than have other forms of economic extra-territoriality. The fact remains, however, that it is within the power of the Department of the Treasury to deem, for tax purposes, income from controlled foreign units to be income of the United States parent company on the grounds that prices charged to overseas subsidiaries have not been high enough to be comparable to prices charged to "unrelated" buyers. Such transfers are considered "exports of taxable profits".

A provision to that effect is included in Section 482, U.S. Internal Revenue Code, and it represents one of the guiding principles of U.S. corporations in dealings with their foreign subsidiaries:

> *In any case of two or more organizations, trades or businesses (whether or not incorporated, whether or not organized in the U.S. and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute a portion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades or businesses, if he determines that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades or businesses.*

It should be clear, then, that if Canada wants to get an equitable share of taxes from foreign-owned firms operating within her borders, Canadian governments should insist more vigorously that from the Canadian point of view "exports of taxable profits" also be prohibited. Such a stance could amount to an imposed profit-splitting formula within multinational corporations.

Canada's current preoccupation with the foreign investment problem reflects, however, a much deeper concern than that solely arising from economic considerations. A great many Canadians express anxiety over the effects of the multinational corporation on their life style, their value judgements and their national distinctiveness.

VI. DOES CANADA NEED MORE INVESTMENT FROM ABROAD?

It is widely alleged that our economy needs continued inflows of investment from abroad because there is a quantitative gap between our demands for investment capital and the size of our domestic savings. Yet this contention is only valid if the investment levels that are considered adequate by international standards are not sufficient to meet our own desires for rapid economic growth. Given reasonably ambitious goals for economic growth which would bring the country's output relatively close to its potential in terms of utilization of resources, not much evidence can be found to support the view that Canada's domestic savings are inadequate.

Investment Demand and Supply of Savings

According to estimates by the Economic Council of Canada, an average annual growth rate of 5.5 per cent in real output between 1967 and 1975 will roughly equal this country's growth potential. This rate, however, requires an average rate of growth in expenditures on new business plant and equipment of 5.8 per cent per year, or investment in 1975 of $30.2 billion.

Growth of Real Output and Expenditures on New Business Plant and Equipment

(average annual percentage change)

	1950-67	1967-1975 Potential
Output	5.1	5.5
Expenditures on New Business Plant and Equipment	5.3	5.8

Source: Economic Council of Canada, **Sixth Annual Review: Perspective 1975**, *September 1969. Table 6-1, p. 93.*

This rate of growth in expenditures on new plant and equipment will bring the 1975 level of investment to $30.2 billion. Domestic savings are expected to provide up to 95 per cent of the requirements. Only $1.5 billion, or 5 per cent of total savings, would have to come from external sources defined as non-resident saving.*

* *The net use of foreign saving is equivalent to a deficit on current account. It is interesting to note that in 1970 and 1971 Canada's balance-of-payments recorded current account surpluses which, combined with long-term capital inflows, had the effect of raising the country's foreign exchange reserves.*

Investment Demand and Supply of Saving

	1967	At Potential in 1975	1967	At Potential in 1975
	(billions of dollars)		(as a per cent of GNP)	
Demand for Saving				
Business Gross Fixed Investment	12.5	23.0	19.0	19.5
New residential construction	(2.8)	(5.2)	(4.3)	(4.4)
Business plant and equipment	(9.7)	(17.8)	(14.7)	(15.1)
Government Gross Fixed Investment	3.0	6.0	4.6	5.1
Value of physical change in inventories	0.4	1.2	0.6	1.0
Total	15.9	30.2	24.3	25.6
Sources of Saving				
Government Saving	3.4	6.5	5.2	5.5
Private Saving	12.6	22.2	19.3	18.8
Personal	(3.3)	(4.1)	(5.1)	(3.5)
Business	(9.3)	(18.1)	(14.2)	(15.3)
Non-resident saving*	0.7	1.5	1.0	1.3
Statistical discrepancy	–0.8	–	–1.2	–
Total	15.9	30.2	24.3	25.6

Source: Op. cit. Table 6-2, p. 94.

What would happen if non-resident savings were not available?

Since capital inflows from abroad are distributed over private as well as governmental investment, a halt to these inflows – here a theoretical assumption – would create a savings gap resulting in a 5 per cent reduction of the projected investment level.

This would mean that the required average annual rate of growth in fixed capital formation previously estimated at 5.8 per cent would drop to roughly 5.5 per cent, causing also a decline in the projected average rate of growth of the GNP from the previous 5.5 per cent per year to approximately 5.3 per cent. The difference of 0.2 per cent per year does not appear to constitute a factor of great importance.

The conclusion may be drawn from this somewhat simplified reasoning that, although new capital inflows (on a net basis) add to Canada's performance in terms of economic growth, they are now far from having a great significance. Also the possibility cannot be dismissed altogether that a savings gap caused by non-availability of new foreign capital inflows would,

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* *Net use of resources from abroad; retained earnings of foreign-owned corporations are included in business saving.*

under certain conditions, not be filled by Canadians. The Economic Council of Canada has estimated that personal savings will measure 3.5 per cent of GNP in 1975, compared with 5.1 per cent in 1967, and 3.6 per cent in the period 1950-67.

Provided that there is a trend in the foreign-controlled sector of the Canadian economy to re-invest most of their net earnings in Canada, and that Canadian capital markets are capable of streamlining the flow of domestic savings into domestic ventures, the country appears capable of generating enough savings to provide for its investment needs at a level required for healthy, but not above average, economic growth.

Capital Inflows and Debt Servicing

As already mentioned, Canada's economic growth performance in the last two decades has been not better than average among OECD countries. Against this background, one must ask what role new capital inflows played if they did not raise the country's economic activity to levels substantially above the average.

According to Statistics Canada data and estimates by the Economic Council of Canada, the total supply of savings in the period 1950-67 approximated 20.5 per cent of gross national product.* Non-resident saving constituted 2.2 per cent of GNP. Thus, more than 10 per cent of the aggregate investment in that time-span can be attributed to new capital inflows from abroad.

Simultaneously, however, Canada's external debt-servicing has risen almost precisely in proportion to the growth of the GNP (see p. 24). Between 1959 and 1969, payments of interest and dividends constituted, on the average, 1.9 per cent of Canada's gross national product. Together with payments of royalties, patent license fees, and various other dues which Canadian subsidiaries must pay to their foreign-based head offices, debt service charges have been recently estimated at $2 billion per year, or 2.6 per cent of GNP.

These funds transferred abroad are generated in Canada, but do not constitute our savings. By foregoing investment opportunities in the past, Canada has thus reduced its current flow of savings under fully domestic control.

In such circumstances, new net capital inflows have had the effect of neutralizing the financial outflows representing debt servicing. Stability in Canada's investment levels has been bought at the price of a gradual rise in our international indebtedness.

This trend has its logic. The more foreign capital there is in a country, the higher the service charges for its use and the greater the temptation to ask for more capital to offset the outflow of money. The larger the share of the economy controlled by foreign corporations, the stronger the trend towards perpetuating the country's economic dependence.

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* *Excluding government saving allocated to government investment.*

It would, therefore, be a self-delusion to believe that, under an "open-door" policy on foreign investment, Canada's economy will one day be independent enough to make the use of foreign savings redundant. We have now the highest foreign control ratios of any country in the world, but also a high frequency of governmental missions abroad aimed at obtaining new investment for a country suffering from high levels of unemployment.

Investment in the Foreign-controlled Sector of the Economy

The vulnerability of Canada's economy to potentially unfavourable attitudes of multinational corporations does not, of course, stem from the possibility of seeing the inflow of new capital halted. The most important fact which any Canadian policy on foreign investment must consider is that the non-resident-controlled sector of the Canadian economy determines the use of a large part of Canada's business savings which, according to the Economic Council of Canada, can be expected to reach $18.1 billion by 1975, or 15.3 per cent of the gross national product.

Any prolonged panic among foreign investors already operating in this country could contribute to a painful investment slowdown in the economy and exacerbate the employment situation.

Canadian sensitivity to the attitudes of foreign investors is mainly in the area of direct investment. Loan capital has its fixed interest charges, and portfolio investment from abroad is not associated with control. But direct investment carries with it the exercise of property rights. In the corporate scheme, and more particularly in the case of the multinational enterprise, a controlling interest entitles the foreign owner to wide powers of discretion with respect to production, marketing, research and development, *investment and reinvestment of earnings,* and also pricing among affiliated companies in various countries, with potentially numerous and important economic effects in the host country.

Were Canada to opt for a restrictive posture towards foreign direct investment, a major alternative would lie in changing the nature and composition of Canada's capital transactions with the rest of the world. This would mean that we would have to strive towards substituting foreign direct investment with inflows of non-equity capital.

However, a policy on new investment from abroad can hardly leave the domestic foreign-controlled sector of the Canadian economy unaffected with respect to their reinvestment decisions. This awareness only further amplifies the reality that the issue of foreign investment is of a very delicate nature in Canada, and may, according to some, be too complex to remedy.

It will be difficult to formulate restrictive policies on foreign investment without endangering the internal investment climate in Canada. Moderation on the part of the policy makers may, however, help to maintain confidence among foreign investors and contribute to their better understanding of Canada's national aspirations.

Some Balance of Payments Considerations

Capital inflows may present serious problems when they occur at a time when there are surpluses on current account. The combined effect of surpluses on both the capital and current accounts will, under a floating rate of exchange, force up the value of the Canadian dollar, thus causing disturbances in exports and difficulties for manufacturing industries. Under a stable exchange rate, the situation may be equally difficult. Accumulation of large foreign exchange reserves may bring unbearable pressure for a revaluation of the country's currency in addition to making the management of the domestic economy more difficult since the financing of larger and larger exchange reserves involves expansions of the money supply which may be undesirable.*

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* *Canada's last experience with this phenomenon occurred in the spring of 1970 and resulted in the freeing of the Canadian dollar in May, 1970.*

VII. POLICY ALTERNATIVES AND POLICY TOOLS

On the basis of the knowledge available of the benefits and dangers of foreign investment, however incomplete that knowledge may be, this country's policy makers will have to decide in which direction to go: towards continental integration with the U.S. economy and a basic reliance on American-controlled multinational corporations for economic growth, or, towards a more independent national economy based increasingly on Canadian firms and Canadian national guidance. We must know where we are going *before* we ask how we will get there. In the absence of major policy changes, Canada will, by and large, continue to pursue its "open-door" policy on foreign investment. This, also, is one of the basic policy alternatives.

Continued Open-door Policy — One of the Alternatives

Perhaps the most pertinent issue to be examined with respect to an "open-door" policy is a determination of its likely effect on the Canadian economy in the 1970's and 1980's. Would foreign control of the Canadian economy increase, decrease, or remain stable? How would it affect employment and economic growth?

Over the last 50 years, non-resident control of Canada's industries has been growing gradually but uninterruptedly. As of 1970, some 8,500 firms in Canada were known to be controlled by foreigners, a full 80 per cent of them by Americans. The number of U.S. takeovers of Canadian companies has recently been estimated at about 100 per year. Will, then, this trend continue if nothing is done to halt it, or will it subside?

A number of factors seem to indicate that Canadian enterprises are, with certain exceptions, too weak to offer long-term resistance to takeover bids by large U.S. and other foreign corporations. The main reason for this weakness is smaller size, with all its accompanying handicaps, such as limited access to financial, managerial and technological resources. Giant U.S. corporations, as well as medium-sized American companies are confronted on the Canadian side by firms which, more often than not, are ten, twenty or thirty times smaller. Such disparity in size and financial resourcefulness, thus, permits large companies to be the highest bidders whenever the shareholders of Canadian firms with suitable assets are ready to relinquish control.

The disparity in size of corporations is illustrated by the number of firms with $1 billion of sales:

Number of Companies with Sales of $1 Billion or Over

Headquarters located in:	1967	1968	1969
United States	83	104	148
Canada	–	1	2

The two Canadian-based companies listed in that category in 1969 were Alcan Aluminum of Montreal with sales of Can.$1.3 billion and Bell Canada of Montreal with revenues of $842 million from telephone operations plus $200-$300 million from manufacturing activities.

The fragmentation of Canadian industries also appears to be very pronounced when compared with other industrially advanced nations:

Number of Large Industrial Corporations in Selected Countries

	1969 Sales	
Headquarters located in:	$1 billion and over	$500 million to $1 billion
Germany	15	5
Japan	13	21
Britain	11	20
France	11	8
Italy	4	2
Switzerland	2	4
Netherlands	2	—
Netherlands-Britain*	2	—
Canada	1	5
Belgium	1	2
Australia	1	1
Luxembourg	1	—

* *Royal Dutch/Shell Group, and Unilever.*

Source: **Fortune**, *May and August 1970.*

When it is considered that Canada's GNP is approximately half that of Japan, Germany or Britain, the relative number of large Canadian firms capable of challenging the world's industrial giants appears to be very small indeed.

But it is not necessarily the size of enterprises alone which makes Canadian businesses vulnerable to takeovers by U.S. interests. The use, in both countries, of the same language, the exposure to the same forms of advertising, the very similar cultural framework in which the economy operates, and last but not least the proximity of the United States to the inhabited areas of Canada, make acquisitions of Canadian businesses a relatively easy matter.

Of course, not only companies can be bought, but also natural resources, tracts of land for future development, real estate for residential, commercial, industrial or speculative purposes, recreational land, and land for other purposes. The average American income is approximately 25 per cent higher than Canadian; consequently, wealthy Americans can be strong bidders for land available for sale. It should also be recognized that real estate acquisitions in Canada may be made by American firms and individuals as a hedge against inflation, if strong inflationary pressures persist in both countries.

In summary, everything indicates that, under an "open-door" policy, Canadian ownership in the domestic economy would continue to shrink. Once the control of a substantial portion of the economy is in the hands of large foreign corporations, the process tends to become

irreversible unless the host country changes the rules under which foreign-controlled firms operate: experience shows that U.S. parent companies do not like to diffuse equity ownership in their subsidiaries.

Politically, the foreign-owned sector of the economy derives much strength from the fact that it has on its payrolls very large numbers of Canadian employees. Any plans by the government to impose restrictions on foreign investment would tend to be regarded, rightly or wrongly, as attempts to deprive these employees of their jobs.

Balance of payments considerations will also tend to strengthen the position of those Canadian policy-makers who favour an unrestricted foreign-investment policy, because increased repatriation of profits from Canada can, in the short run, be painlessly offset by more capital inflows. The phenomenon has the characteristics of a vicious circle: as foreign investment in a country increases, it becomes increasingly more important to sustain the inflow in order to pursue economic growth at normal levels.

The above circumstances seem to indicate that the trend towards what many call the "Americanization" of the Canadian economy is very strong and, under a non-interventionist policy, irreversible. This is a cause of concern for many Canadians. However, those who are not nationalistically inclined will say that ownership and control of industries is irrelevant as long as the economy continues to grow. How then will foreign investment contribute to Canada's future economic growth?

Prospects for more U.S. investment in the 1970's and 1980's lie principally in the resource industries. The United States will face an ever deepening deficit of energy resources and raw materials and will likely have to import, on an accelerating scale, crude oil, natural gas, iron ore, copper, nickel, lead, zinc, manganese, chromite, potash, uranium, pulpwood and timber. According to some estimates, by 1980 the U.S. is expected to hold 9½ per cent of the world's population yet consume 83 per cent of all the raw materials and resources produced globally. Such estimates are doubtlessly an exaggeration, but a rapidly growing U.S. demand for imported raw materials seems to be certain. Hollis Dole, Assistant Secretary of the Interior for mineral resources, draws the following conclusions:

> *First, our (U.S.) requirements for raw materials and energy in this country will mount rapidly over the next three decades.*
>
> *Second, throughout the world, competition for the resources that supply these basic necessities will increase enormously.* *

What Mr. Dole refers to are the raw material requirements of other industrial nations, mainly Japan and Western Europe. What Canada as a resource-rich country may, then, expect is the growing investment activity of foreign oil and mining companies, first of all American, but also Japanese and West European. A prolonged investment boom can

* *"Nixon specialist paints bleak picture of resource shortages in U.S."*, **Globe and Mail**, *March 9, 1970.*

consequently be expected to provide employment opportunities for Canadians, and, equally important, tax revenues for governments.

However, the belief that Canada's foreign-dominated resource industries could substantially boost employment opportunities and governmental tax intakes must be viewed with caution. Resource industries are much more capital-intensive than labour-intensive, and expansion in the extractive industries does not automatically induce development in the processing industries. Policies designed to force mining companies to do some processing in Canada before their materials are exported might, to a certain degree, help in providing more employment for Canadians. However, no large revenue increases should be expected to accrue to the public treasury unless there is a change of policy aimed at substantially reducing or eliminating the tax exemptions enjoyed by the oil industry and mining.

The vigorous growth of Canadian manufacturing industry is, under the "open-door" policy for foreign investment, much less certain. Multinational corporations will, no doubt, continue to produce manufactured goods for Canada's domestic market, particularly if they enjoy the country's tariff protection. The diffusion effect of growth in the resource industries may, to a certain extent, also be felt in the manufacturing and service sectors.

However, the moderate size and the dispersion of Canada's domestic markets, and the geographical distance separating Canadian production centres from large markets abroad present disadvantages which will weigh heavily in decisions taken by multinational corporations on the location of new large-scale manufacturing units. Therefore, it is difficult to see how a mechanism could emerge under a non-interventionist policy that would transform Canada's relatively inefficient structure of secondary manufacturing into a form comparable with the world's leading industrial nations.

Failure, however, to boost the development of secondary manufacturing in Canada will likely bring disorderly economic growth characterized by high unemployment levels and low profiles of professional skills in our labour force.

Moderate Economic Nationalism — Another Alternative

The fundamental difference between Canada's "continentalists" and "economic nationalists" is that the former believe that the nation's sovereignty and cultural identity are not impaired by the power of foreign corporations operating on our soil. This view is dismissed by the nationalists as naive. They are convinced that the country's political and cultural independence, as well as its economic destiny, are at stake if Canadians allow themselves to be gradually deprived of ownership and control of important segments of their economy. Nationalists, therefore, demand government action aimed at first halting and then reversing the trend towards more and more non-resident ownership and control and the imposition of rules of conduct for foreign-controlled firms so that they can better serve the interests of Canada.

Given this country's degree of reliance on foreign-controlled investment, unique among independent nations, it is not surprising that there is much emotionalism in the manner in which many concerned Canadians approach this problem. Positions range from an extreme

or radical nationalism to various kinds of more moderate approaches. The medicine prescribed for curing the ills of excessive economic dependence range from radical socialist proposals of nationalization of key sectors of the economy to the much less extreme proposals of influencing the behaviour of foreign-controlled corporations.

The view taken here is that nationalistic extremism would be economically disastrous and therefore self-defeating. The panic that would result in the foreign-owned sector of the economy would slow down investment, increase unemployment and undermine the country's balance of payments.

To be successful, an economic policy directed towards curbing foreign domination must be moderate, yet firm and comprehensive. Such a policy, which might be called a policy of enlightened national self-interest, stands a fair chance of success if implemented gradually over time and in a fair-play atmosphere *vis-a-vis* the foreign multinational corporations. Admittedly, however, it would be impossible to avoid the confrontations that always occur when vested interests are involved.

The climate for such a policy appears to be ripe. The foreign investment issue has been intensely debated in Canada for a number of years, and representative opinion polls indicate that a major segment of the Canadian public is concerned about foreign domination of our economy and is prepared to support measures designed to reduce foreign influence.

Also, there are signs that Americans have a growing understanding of Canada's national aspirations and take a more sympathetic attitude towards our intentions to strengthen Canadian economic independence.* In December 1970, *Forbes Magazine* presented this view to its American readers:

> *To refuse to compromise with Canadian economic nationalism will be to encourage it. To go along with it will entail some loss of profit or privilege by U.S. business, yet that course will almost certainly prove to be the most sensible of the alternatives.*

Policy Tools

This report is not intended to be a blueprint for action. Its primary function is a diagnostic one, while therapeutic advice is left to other more detailed studies involving the feasibility of proposed measures. It appears useful, however, at this stage to systematize the policy instruments which those engaged in detailed policy formulation might take into consideration.

The whole range of policy tools aimed at strengthening Canadian ownership and control of the domestic economy may be grouped under four headings:

A. Exclusion of foreigners from industries of national importance.

B. Restrictions on new inflows of foreign direct investment.

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* *Written prior to President Nixon's New Economic Policy of August 15, 1971.*

C. Positive measures to strengthen Canadian ownership and control.

D. Regulations on the conduct of foreign-based multinational corporations.

A. Exclusion of foreigners from industries of national importance

To date, foreign direct investment has been legally restricted in a number of crucial sectors of the Canadian economy, namely, banking, insurance, trust and loan companies, radio and television broadcasting, and communications. The maximum proportion of non-resident ownership permitted in companies of the finance sector (banks, insurance, trust and loan companies) is 25 per cent; the maximum proportion of ownership permitted by any single person is 10 per cent. *De facto* limitations on foreign ownership have existed in transportation (airlines, railroads) and public utilities (provincial electric energy authorities).

Recently, federal restrictions on foreign ownership in Canada's uranium mines have been extended. The general rule is that foreign participation in any uranium property should be limited to 33 1/3 per cent of its ownership and that of any single foreign investor or associated group of investors to 10 per cent of the company's shares. With respect to existing companies in which foreign ownership is more than 33 1/3 per cent, or even more than 50 per cent (e.g. Rio Algom Mines Ltd. of Toronto controlled by Rio Tinto-Zinc Corp. Ltd. of London), the regulations do not demand selling off the non-allowable ownership surplus to Canadians, but do not permit the handing over of control to other foreign interests.

The above-named sectors of the Canadian economy in which control is legally or *de facto* reserved for nationals have been partially under public and partially under private and mixed ownership. All types of ownership have co-existed in Canada for many years and it would be frivolous to suggest that our economic system would collapse or suffer great damage if some new industries, which so far have been open to foreign investment, were added to the nationally-controlled sectors by either nationalization (public ownership) or Canadianization (private or mixed ownership).

A long-term advantage could be expected from legislative decisions clearly dividing the country's economic sectors into those where

a) foreign ownership is prohibited;

b) foreign ownership is allowed up to 25 per cent of equity;

c) foreign ownership is allowed up to 49 per cent of equity;

d) foreign ownership is allowed without limitations.

For foreign investors, as well as domestic businessmen and shareholders, an explicitly defined policy is clearly preferable to an irregular pattern of governmental intervention in selected cases. Sudden governmental initiatives to prevent major takeovers of Canadian companies are poor substitutes for a comprehensive policy, unless such actions are

generalized and institutionalized under a special agency where all cases are subject to approval or rejection. But governmental moves to block only selected takeovers may unintentionally bear the symptoms of discrimination against particular firms or individuals. The federal government now seems to be committed to a more comprehensive approach and the announcement "without undue delay" of a new foreign investment policy is awaited with interest.

The most obvious difficulty in formulating and implementing a workable, Mexican-type foreign investment policy lies in the discrepancy between the long-term goals of Canadianization, and the economy's limited capacity or preparedness to endorse a rapid pace of change. Due to the high levels of foreign ownership in Canada's economy, a policy of Canadianization would not only involve restrictions on foreign takeovers, but also changes in the *status quo,* i.e. buying back control of previously foreign-dominated industries. Such changes always meet strong resistance from vested interests. But to disregard the difference between what is desirable for the future and what is feasible now means to engage in an exercise in futility. In August 1970, the House of Commons External Affairs Committee under the chairmanship of Ian Wahn suggested that the government require all companies in Canada be 51 per cent Canadian-owned. This sweeping recommendation was, unfortunately, not accompanied by any outline of a workable strategy aimed at achieving this objective.

The solution to the problem might lie in a selective and step-wise introduction of policy measures, at intervals of, say, four to five years, with reasonable periods of time for business to adjust to new requirements on equity distribution. This should also mean that the financial cost of buying back foreign-controlled firms would be spread out in time, and that industries with a key role in the long-term national strategy, as well as sectors of cultural significance, would be subject to re-Canadianization earlier than other sectors.

B. Restrictions on new inflows of foreign direct investment

Restrictions on inflows of new foreign direct investment are somewhat less controversial than across-the-industry ownership regulations inasmuch as they do not aim at driving foreign capital out of their existing positions. Their objective is merely to halt or limit the new infusions of foreign ownership capital and to rationalize such inflows so that they can best serve the interests of the country.

The basic means to control the flows might likely be regulations under which foreign and foreign-controlled firms, as well as non-resident individuals, are required to obtain a governmental permit to set up new plants or establish subsidiaries, branch plants, sales outlets, or take over other companies, or acquire land or other real estate.

The form and the departmental relationship of an agency or agencies entrusted with this responsibility are not of paramount importance. In Canada, most suggestions for establishing such an agency call it "a take-over review board".

The primary advantage of a supervising board stems from the flexibility it offers to the government in adjusting policies to changing conditions. Only very general guidelines seem

necessary to make a takeover review agency operational, and policies do not need to be spelled out in advance and approved by parliament.

This operational advantage, however, may prove to be a weakness if the agency meets major criticisms on partial or discriminatory decision-making. Also, prolonged arbitration and appeal procedures, if such were instituted, may cause considerable irritation.

In Canada, moreover, the limited effectiveness of restrictions on new inflows of foreign direct investment arises from the insignificance of these inflows relative to the self-sustained growth of the large foreign-controlled sector within the Canadian economy. In Europe, where foreign control levels are incomparably lower, a check on the flow of investment from abroad is also a check on the accumulated value of that investment. Not so in Canada.

However, there are sectors in which non-residents have not yet secured a major hold, e.g. in the ownership and control of Canada's recreational lands and in securities firms. Here, restrictions on foreign acquisitions may have a much higher degree of effectiveness (as far as keeping these sectors in Canadian hands is concerned) than in industries already dominated by foreign capital.

Under new Ontario regulations for the leasing of publicly owned cottage lands, for example, non-residents are not allowed to apply for leases earlier than one year after they have been offered to Canadian residents. The sale of crown land for cottage sites has been abandoned altogether.

Ontario's recent registration requirements for all classes of security dealers and paperback and periodical distributors also fall into the category of measures designed to halt new inflows of foreign direct investment without, however, affecting the status of existing firms controlled by non-residents. The standard requirement for all new registrants in these two sectors is that no more than 25 per cent of one firm's capital may be owned or controlled by non-residents, and no more than 10 per cent owned or controlled by a single person or associated group of persons who are non-residents. The new regulations also apply in case of material change in the control of existing registrants.*

New inflows of foreign ownership capital might also be slowed down, especially in real estate, by amending the rules governing the operations of Canadian lending institutions. There appears little justification for abundant distribution of Canadian mortgage funds to non-residents so that they can proceed to title when their Canadian loans have been repaid by their Canadian tenants. If foreign acquisitions of Canadian real estate are to be allowed by law, foreign purchasers should pay, in cash, the full value of that real estate or at least a percentage substantially above 50 per cent.

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* *See* **Ontario Regulation to the Securities Act, 1966***, July 14, 1971; and* **The Paperback and Periodical Distributors Act, 1971.**

C. Positive measures to strengthen Canadian ownership and control

Restrictive policies on investment from abroad, although widening the scope for Canadian initiatives, are not likely to directly contribute to Canada's self-sufficiency in the supply of capital nor will they automatically strengthen Canadian entrepreneurship. Positive measures are also required.

In a broad sense, sound monetary and fiscal policies accompanied by an aggressive foreign trade strategy and governmental support of advanced-technology industries are necessary prerequisites for the healthy growth of Canada's economy. However, unless a pro-Canadian bias is built into selective policy measures, these broad conjunctural policies will have the effect of promoting the growth of not only the Canadian sector of the economy, but also, and even more so, of the foreign-controlled sector.

In our approach, the implementation of a healthy economic growth policy is assumed to be a precondition for more specific measures aimed at increasing Canadian savings, inducing Canadians to invest their savings in Canadian enterprise, encouraging Canadian ownership and entrepreneurship, inducing financial institutions to adopt more "pro-Canadian" attitudes, and promoting the growth and the establishment of Canadian enterprises.

The range of these specific measures may tentatively be grouped under tax incentives, capital market regulations, and institutional initiatives.

Tax Incentives: The dividend tax credit is the primary device in use that seeks to encourage Canadians to invest their savings within Canada. Canadian residents will be allowed to deduct from their tax an amount equal to 33 per cent of the net dividends they receive from Canadian taxable companies, partially to minimize the effect of the double taxation of corporate profits and partially to encourage participation in the ownership of Canadian companies. No dividend tax credit is given to individuals who hold shares in foreign corporations for the corporate tax paid by these corporations.

In Ontario, corporation income tax legislation has recently been amended permitting deduction of interest costs on money borrowed to purchase shares of other companies. This amendment should increase the financial ability of Canadian firms to bid for the takeover of other Canadian or non-Canadian companies. It is also hoped that this measure will slow the rate of foreign takeovers in Canada. The federal government incorporated a similar tax measure in its 1971 budget.

Ontario's 1971 budget has also recommended legislation aimed at reducing provincial succession duties to ease the tax burden on Canadian family farms and family businesses being passed to spouses, children or grandchildren. One of the objectives of the proposed tax law amendment is to prevent these farms and businesses from being sold to non-residents.

Many additional techniques can be exploited wihin the tax system to aid the growth and survival of Canadian-owned businesses. In fact, the whole issue of possible future governmental intervention through the tax system deserves very careful investigation by tax specialists.

Capital Market Regulations: Increased self-sufficiency in the Canadian capital market might be achieved by applying restrictions to the foreign investment activities of Canadian insurance companies, trust and investment companies, pension funds, mutual funds and other financial institutions. Such restrictions would serve to make more investment funds available to Canadian firms and to provincial and local governments which have often had to rely on foreign capital markets.

A substantially higher degree of intervention in the operations of the capital market might further be achieved by selectively limiting the scope and character of long-term lending to foreign-controlled corporations operating in Canada by Canadian banks and other financial institutions. Canadian equity financing could then be encouraged as part of a long-run program of "buying back Canada".

Institutional Initiatives: A set of measures under this heading encompasses a greater pro-Canadian orientation of existing federal and provincial institutions (such as the Industrial Development Bank, the Central Mortgage and Housing Corporation, and the Ontario Development Corporation), as well as the establishment of such new institutions as the Canada Development Corporation.

In addition, the strengthening of genuinely Canadian industries might well be accomplished through the establishment of large Canadian corporations in most industrial sectors. While it takes time to acquire technological expertise and access to large markets, the overwhelming presence of foreign-controlled enterprises in Canada's chemical, electrical, machinery and transportation industries, as well as in our natural resource industries, should not dissuade Canadians from choosing a core of domestically-controlled companies whose growth could, in time, assure a Canadian presence among the corporate giants of the world. It seems logical to suggest, then, that large domestically-owned industrial corporations in Canada be given substantial governmental assistance, especially for research and development.

D. Regulations on the conduct of foreign-based multinational corporations

Irrespective of the degree of restrictiveness in future Canadian policies on foreign investment, the presence in Canada of foreign-based multinational corporations will remain a fact of life for decades to come. It is therefore imperative that any Canadian policy on foreign investment seek to maximize the benefits derived from the operations of foreign-based firms.

It has always been regarded as obvious that, in principle, non-residents and non-resident-controlled firms abide by Canadian laws. There may be a significant difference, however, between the legally correct behaviour of a firm, especially under liberal laws and regulations, and that firm's potentially most beneficial contribution to a host country's economy. While the multinational corporation maximizes its own international objectives and is strongly influenced by the legislation and policies of its home government, it must also conform to the legal requirements of the country where its subsidiaries operate. If the laws of the host country happen not to be demanding, the economic interests of that country will then likely not be served.

This reasoning no doubt explains why in 1966, the Federal Minister of Trade and Commerce considered it advisable to issue a set of guiding principles for the good corporate behaviour of foreign subsidiaries operating in Canada. Unfortunately, such guidelines tend not to be supported with strong enforcement. Only when government is prepared to use stronger measures of persuasion in the case of non-compliance do the guidelines become, in fact, regulations.

One must ask, however, to what extent government would be prepared to move into the field of regulatory policies. Would it go as far as to regulate the activities of foreign-controlled firms much more closely than those of domestically-controlled corporations?

It is generally desired that foreign-controlled firms operating in Canada conform to certain standards. For example, they should:

a) give advance notice of planned shut-downs of plants and lay-offs of employees;

b) disclose and publish financial information;

c) offer minority ownership of Canadian subsidiaries to Canadians;

d) assure the required participation of Canadians in management and on the board of directors;

e) process natural resources in Canada;

f) favour Canadian firms for the purchase of materials, components, capital equipment, and services;

g) develop exports to overseas markets;

h) assure adequate levels of research and development work in Canada;

i) retain an adequate level of profits for re-investment in Canada;

j) assure, through proper intra-corporate pricing and cost-sharing, an adequate level of taxable profits in the Canadian subsidiaries;

k) comply with Canadian law even though it conflicts with the law of the parent company's home country.

Some of these general requirements have, in fact, been institutionalized through legislation. For instance, disclosure of financial information is required under the Canada Corporations Act, as amended June 11, 1970. In Ontario, laws have been passed to oblige companies, either foreign or domestically-controlled, to give advance notice of planned plant closures. Local processing of raw materials is also under a degree of enforceable provincial regulation

within the responsibility of the Ontario Department of Mines and Northern Affairs. Current Canadian tax statutes include provisions designed to ensure that foreign-owned subsidiaries in Canada are taxed on the proper amount of income attributable to their operations, and to frustrate devices that might undermine Canadian tax revenues. It will be apparent from earlier analysis, however, that it is of great importance that the tendencies of multinational corporations to export taxable profits be constantly and effectively policed both *via* legislated provisions and vigorous enforcement. In this area, much can be learned from the experience of the United States itself.

Although it can be expected that more stringent regulations on the conduct of foreign-based multinational companies might induce them to serve better the interests of Canada, this fact should not lead us to regard a program of increased re-Canadianization of our economy as redundant. For the globally-oriented multinational corporation, the economic and cultural interests of the host country are but one factor in a complex equation, and the host country's rules cannot therefore unilaterally upset the logic and principles upon which the multinational corporate system functions and develops in the world.

VIII. FEDERAL AND PROVINCIAL AUTHORITY TO DEAL WITH FOREIGN INVESTMENT*

The development of an appropriate and effective Canadian posture towards non-resident ownership and control in the economy will require both the careful integration of national and regional interests in overall policy formulation, and co-operation and co-ordination among federal and provincial governments in policy implementation, In general, Ottawa will be looked to for leadership and direction on those aspects that apply to the nation as a whole. In turn, provincial governments will be charged with catering to the particular features and needs of their economies and people. It is in this context that the division of responsibility and jurisdiction between the two levels of government must be examined.

Constitutional and Legal Basis for Division of Powers

The constitutional basis for the division of powers is provided in the British North America Act. Section 91 confers on the federal parliament the "exclusive" right to legislate with respect to (i) the public debt and property; (ii) the regulation of trade and commerce; (iii) the raising of money by any mode or system of taxation; (iv) patents and copyrights; (vii) aliens; (viii) generally for the peace, order and good government of Canada; and (ix) residually with respect to matters not assigned exclusively to the provinces. (This enumeration, of course, excludes those items not relevant to the present context.)

On the other hand, the provinces are, by Section 92, accorded "exclusive" jurisdiction with respect to (i) direct taxation within the province for the raising of revenue for provincial purposes; (ii) the management and sale of the public lands belonging to the province and of the timber and wood thereon; (iii) local works and undertakings, except inter-provincial or international transportation and communication lines and works declared by the federal government to be for the general advantage of Canada (e.g. grain elevators); (iv) the incorporation of companies with provincial objects; (v) property and civil rights; and (vi) matters of a merely local or private nature. Additionally, the general effect of Section 109 of the BNA Act is to vest natural resources and prerogative rights arising from them with the provinces, except those that have been transferred explicitly to the Dominion or are subject to excepted trusts or interests.

As interpreted by the courts, these provisions have brought about a divided, and somewhat confused, jurisdiction over economic matters between Ottawa and the provinces. Many, if not most, legislative matters can be argued to be related both to powers assigned "exclusively" to the federal government and to those assigned "exclusively" to the provinces. For example, the federal trade and commerce power has not been given the widest of interpretations, so that the provinces have jurisdiction to regulate businesses under the property and civil rights head. The federal government has power over export trade, yet the provinces' jurisdiction over natural resources has formed a valid basis for legislation requiring processing in Canada.

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* *This chapter is intended to provide only a general interpretation of constitutional jurisdiction. It is not meant to suggest conclusive interpretations of any particular legislation — federal or provincial.*

The federal government's residual power to incorporate companies, more substantial than the provincial power of incorporation, enables Ottawa to confer status and powers on federal companies to carry on business — and related matters, such as the power to hold land — which the provincial governments have difficulty interfering with, although federal companies are, of course, subject to provincial regulation.

To cope with the difficulties of conceptual overlapping of jurisdiction, the courts have looked particularly to the "pith and substance" of legislation which has come before it to establish whether it fell within federal or provincial legislative powers. While judicial interpretation of the BNA Act has recognized that modern legislation which lies primarily within one jurisdiction can remain valid even if it also falls into the other's area of legislative competence, the courts have, nevertheless, attempted to prevent "trenching" by one level of government into the other's primary jurisdiction. In those areas of genuinely overlapping or concurrent jurisdiction, the courts have recognized the primacy of the federal powers to the extent it has occupied or chooses to occupy the relevant legislative field. In other words, provincial legislation on a matter of concurrent jurisdiction will be usually recognized as valid in the absence of conflicting federal legislation.

Against this background, what can be said of the scope for provincial measures over foreign ownership? The matter can, perhaps, best be explored by examining the jurisdictional aspects of the general kinds of policies which might be considered.

Canadian Ownership Requirements

Certain sectors of the Canadian economy presently have ownership restrictions. The federal government has restricted non-resident equity participation in banks under its banking jurisdiction, broadcasting and communications under its communications jurisdiction, and uranium mines under its export control powers. There are *de facto* limitations on foreign ownership via federal regulatory jurisdiction over airlines and railroads. Both the federal and Ontario governments have restricted loan and trust companies' ownership through the respective statutes governing such businesses under federal or provincial incorporation. Finally, provincial hydro authorities, as crown monopolies, effectively bar non-resident equity participation.

One possible approach to foreign ownership might be, as outlined in Chapter VII, to impose requirements on Canadian equity participation — total (100 per cent); majority (51 per cent); or minority (e.g. 25 per cent) — in chosen sectors of the economy.

Imposing restrictions on who may own a corporation's shares, of course, goes to the main basis of limited liability companies, and accordingly, in general, legislative competence originates from the respective federal and provincial powers of incorporation. Corporations are theoretical creatures of the crown prerogative and, as a general rule, a province would not be able to impose basic restrictions on the status and powers conferred by incorporation on a federal company. The province would, however, be in a position to enact such requirements with respect to provincially incorporated companies. So long, however, as a business could avoid the provincial stricture simply by incorporating federally, the provincial policy would be of limited effectiveness.

An important exception to this situation may lie in the area of natural resources. To the extent that natural resource rights, be they mineral or timber, are *owned* by the province, it would be open to a provincial government to grant access to these resources on whatever basis it chooses. The operative legal principle is that a province has a free right to dispose of its property as it sees fit, even if it were effectively to deny natural resource access to non-resident owned companies.

The general conclusion one can draw with respect to imposed ownership requirements, excepting natural resource companies exploiting provincial mineral or timber rights, is that federal-provincial co-operation is the necessary requisite of an effective policy. While federally-incorporated companies presently comprise the greater part of most industries, and are therefore beyond the reach of provincial law with respect to share ownership, a degree of uniformity between Ottawa and the provinces would be necessary to prevent ownership policy being undermined through the device of incorporation in another jurisdiction.

Measures to Stimulate Canadian Saving and Investment

A major way to accomplish many of the objectives of a foreign ownership policy is through *tax measures.* In principle at least, taxes can, on the one hand, be imposed to make activities which are to be discouraged disproportionately expensive, and on the other, to provide substantial tax incentives for activities which are thought to be desirable. Examples of both these kinds of measures can be found in present tax legislation, especially in the recent federal tax reform legislation and the 1971 Ontario Budget.

While tax jurisdiction and operation is split between the two levels of government, it is clear that the federal government has by far the greater potential influence in this area. Income tax clearly offers the greatest scope for effective measures to strengthen Canadian ownership and control — through corporations or individuals — and the federal government, through its larger fiscal share and through its larger and more highly developed audit and administrative capability in taxation, is in a much more powerful position.

A second and important potential means to strengthen Canadian ownership and control is through regulation of the *investment policies* of financial institutions. Tax treatment of institutional investments provides one method already in partial currency. There is also the possibility of direct controls on the investment policies of these institutions. This latter method, however, is not without jurisdictional complexities.

To the extent that financial institutions are incorporated in one jurisdiction or another, that would seem to be determining of legislative competence. Investment may be considered an integral part of a financial corporation's operations. Examples of legislative provisions on investments are provided by federal statutes over federally incorporated insurance and trust companies, and Ontario legislation respecting provincial trust and loan companies.

Mutual and pension funds may possibly be another matter. It is in the nature of such funds that those who participate in them have a beneficial interest which is distinctly different from that of an owner of corporate shares. It is possible that a provincial government might validly legislate investment restrictions on a "property and civil rights" basis in regulating

pension funds or the mutual fund trade as a whole. On the other hand, the bulk of private pension funds are in the hands of federal companies under legal arrangements which make them unsusceptible to provincial legislation. And mutual funds may clearly have an interprovincial, not to mention international, aspect. Suffice it to say that these matters would require close and imaginative legal study should some route other than tax treatment be sought as a means to alter the policies of these institutional investors.

Mortgage lending is a further matter of importance, particularly so since it may facilitate the alienation of Canadian real estate using Canadian savings. A major policy option for the federal government lies in adjusting Central Mortgage and Housing Corporation loan and guarantee policies to discriminate against non-resident ownership. This would affect private lending policies as well. With respect to non-guaranteed conventional mortgages, considerations similar to those on institutional investment policies would generally apply.

Regulating Foreign-controlled Corporations

Many of the features of multinational operations in our country which may be undesirable from the Canadian point of view are, directly or indirectly, suitable for tax treatment, and what we have already said about the relative fiscal importance of the federal and provincial levels of government would apply. Transfer pricing and payments on non-merchandise account for purposes of profit reporting are unequivocally tax matters. The stimulating of research and development or reinvestment of earnings by foreign-controlled firms could probably be most acceptably attempted *via* taxation. Financial disclosure measures could usefully call on the administrative resources of the revenue authorities.

Nevertheless, there is considerable scope for regulation *per se*, much of which would apply to both resident and non-resident owned business, and much of which would be within the purview of provincial rather than federal powers. Examples are afforded by Ontario's notice requirements on plant shutdowns, provincial securities regulation (although there is some dispute as to the limits to which this could go), labour legislation in general, and the Mining Act regulations on local processing. Broadly speaking, much of this regulation is designed to provide protection for the public in regard to certain aspects of carrying on business.

Ownership of Land

One sensitive area of the foreign ownership issue is non-resident ownership of land. What kinds of measures might be adopted to prevent conveyances of land to non-residents or non-resident owned corporations?

The position with respect to provincially-owned land would seem to be reasonably clear. The province is in a position to prevent the sales of its land to foreigners and the recently announced policy of the Department of Lands and Forests affords an example.

Whether provincial legislation which prohibited ownership or transfer of private land by or to aliens would be valid is a more difficult question. Such legislation could be founded on the "property and civil rights" or "matters of a merely local or private nature" provisions of Section 92 of the BNA Act. However, the federal parliament has, by Section 91(25),

jurisdiction with respect to "naturalization and aliens", and the courts seem to have construed this to mean that the federal power is invested with exclusive authority in all matters which directly concern the rights, privileges and disabilities of aliens in Canada. A leading case held that provincial legislation which attempted to prevent the employment of Chinese in coal mines was unconstitutional. Somewhat different considerations might apply if restrictive legislation was cast in terms of residency in the province rather than citizenship.

Ownership of land by non-resident owned, federally incorporated companies seems to present similar problems. Federal letters patent incorporating a business typically confer the power to hold land as an incident to carrying on business, in addition to conferring a Canadian legal personality. It would probably be difficult for a province successfully to prevent federal companies from holding land if that privilege was included in their charter.

Federal-Provincial Co-operation

Clearly many of these problems would be of much less consequence in a co-operative, as contrasted with a conflicting, approach between the federal and provincial governments. There is, nevertheless, the need for some clear delineation of responsibility between the two levels of government.

The federal authority, through its incorporation powers and its *de facto* taxation impact, is in a particularly strong position of influence. This applies especially to the basis on which federal companies may carry on business. A main area of provincial jurisdiction lies in natural resources which are under its control.

In addition, there would be some need for uniformity and co-ordination to prevent the circumventing of one or another's policies or the neutralizing of initiatives. In either case — again with the possible exception of natural resource industries — and both in terms of jurisdiction and influence, there is a need for clear leadership from Ottawa.

IX. SUMMARY REMARKS AND CONCLUSIONS

The large presence of foreign-controlled firms in Canada has created for Canadians a unique situation among industrial nations of the world. In no other advanced country is such a significant proportion of the economy under non-resident ownership. In the past, Canadian policies have helped to bring about this situation since Canada has kept the door open to foreign investors in all except a few sectors of the economy. These policies stand in contrast to the much more restrictive approaches of the vast majority of Western countries.

While it is acknowledged that in the early stages of Canada's economic development the country was helped by inflows of non-resident capital and technology, it is also recognized that a high level of foreign ownership and control in many sectors of Canada's economic and cultural life has recently lessened national self-confidence and created problems which are generally not common to countries relying predominantly on their own domestic capital and their own entrepreneurial and technological resources. These problems extend from the growing cost of Canada's external debt servicing and restraints on the effectiveness of our economic policies to a weakening of our indigenous economic development.

The basic conclusion of this analysis suggests that Canadian policies should be re-evaluated with the objective of creating conditions more favourable to the growth of Canadian control of the economy, and to the expansion of manufacturing industries relying on genuinely Canadian technology and product design.

Current inflows of direct investment from abroad do not play a major role in maintaining high levels of economic activity in Canada. In our opinion, only a relatively small drop in the gross national product would result if new capital inflows ceased — provided, of course, that the re-investment of present profits in Canada's foreign-controlled sector of the economy remain at reasonably high levels. Due to the size of this sector, the maintenance of a healthy investment climate in Canada is fundamentally important to avoid a worsening of the present unemployment situation. Therefore, any new Canadian policies on foreign investment must incorporate a high degree of moderation.

It is essential that the federal and provincial governments define explicitly and collectively their policy orientations and decide whether Canada should move towards continentalism or towards more reliance on indigenous Canadian initiatives. It is only when this crucial direction of policy has been consciously and explicitly adopted that detailed strategies can be worked out to achieve objectives under the existing policy constraints.

There are two workable alternatives for Canada's policy on foreign investment:

1. a continuation of our present "open-door" policy, and
2. a movement towards moderate economic nationalism.

In our opinion, a continued "open-door" policy involves incipient threats to this country's continued economic independence and its cultural distinctiveness. Moderate economic nationalism holds the promise of a gradual reversal of present trends without at the same time endangering economic stability.

It is therefore recommended that:

- the Government of the Province of Ontario espouse the philosophy of moderate Canadian nationalism as the basic framework for policy formulation

- Ontario's position on the foreign investment issue be presented to the Government of Canada as our contribution towards shaping an overall Canadian policy designed to meet the needs and aspirations of our citizens

- moderation and flexibility be built into such a policy as necessary prerequisites to its successful implementation, and that

- radical measures aimed at Canadianizing industries at a fast pace be avoided as self-defeating, primarily because they would engender fear and uncertainty and perhaps precipitate an investment crisis.

Ontario's direct role in shaping policies on foreign investment has already been initiated through a number of legislative measures within provincial jurisdiction. It is recommended that the direction of these policy measures be maintained. Future steps taken by Ontario will, of course, be more likely to succeed if introduced in a climate of fruitful co-operation with both the federal government and our sister provinces.

Ontario. Interdepartmental Task Force on Foreign Investment.

Report.